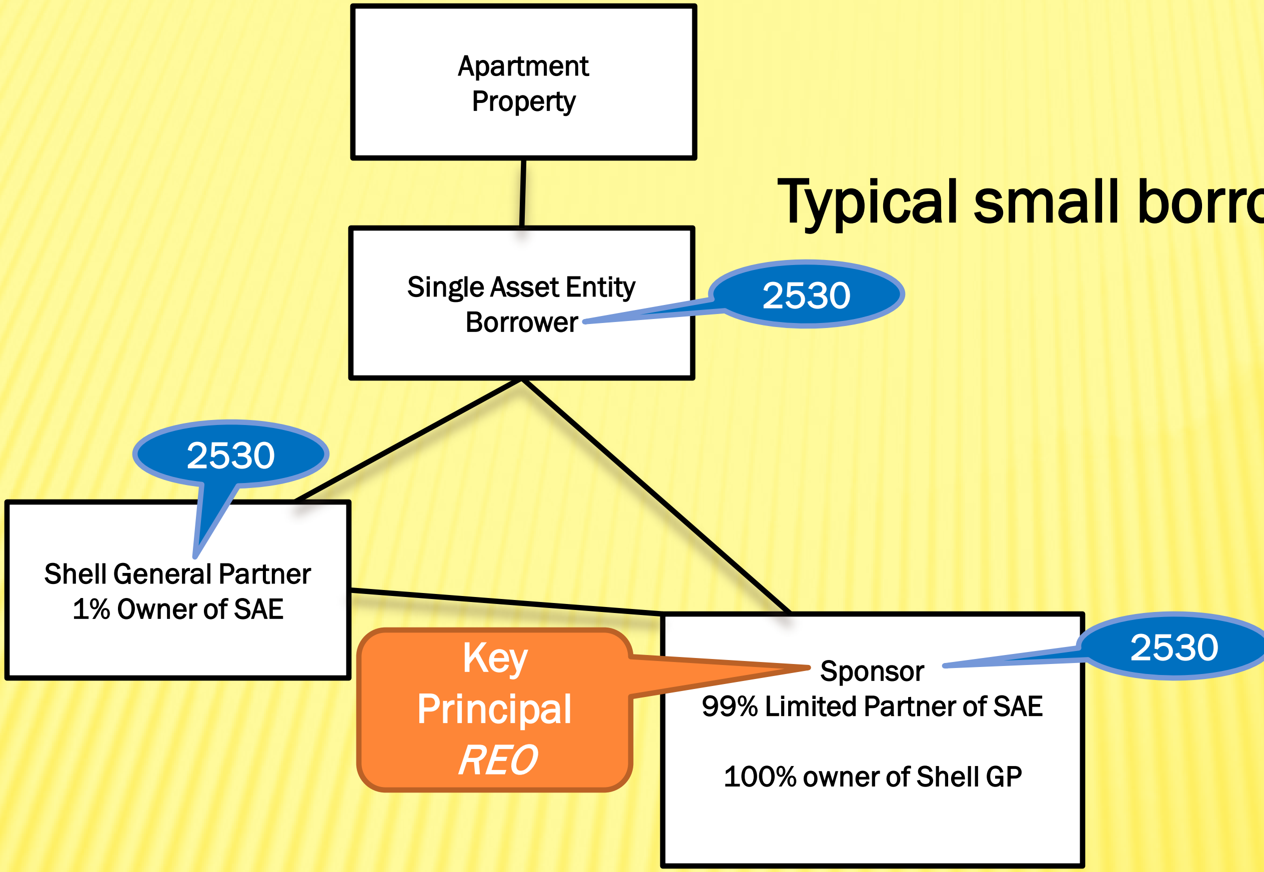
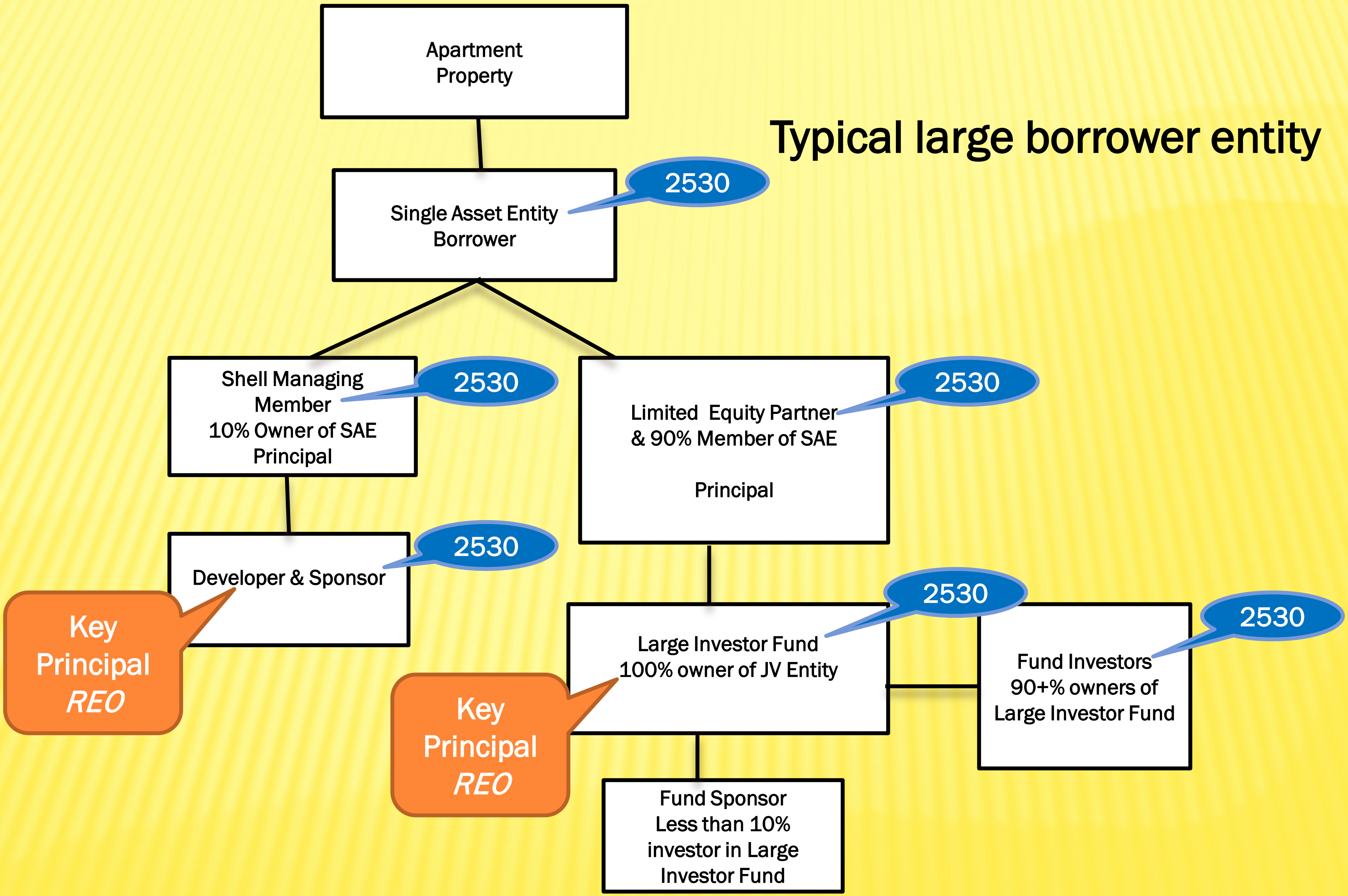
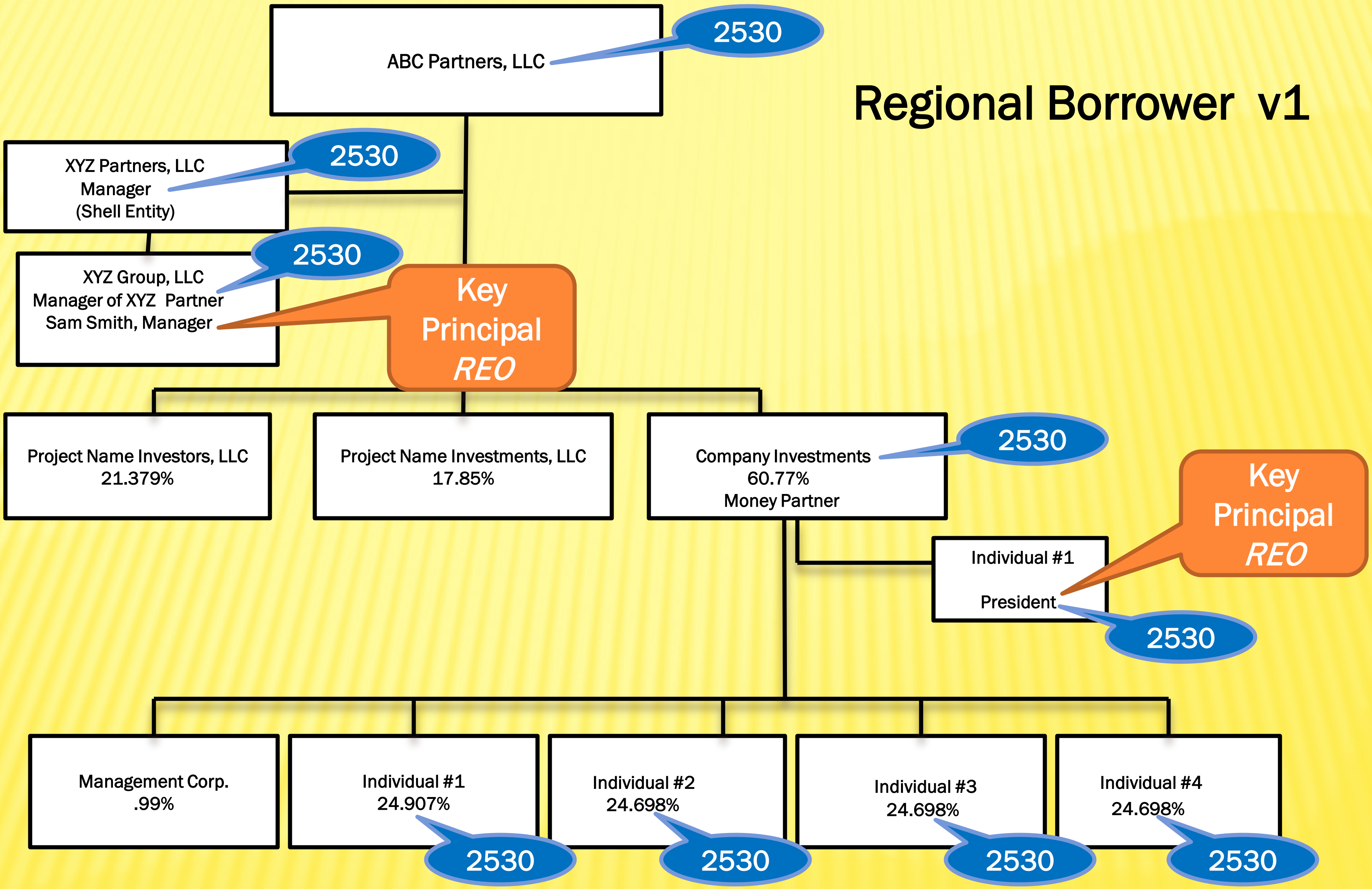
Typical small borrower ownership



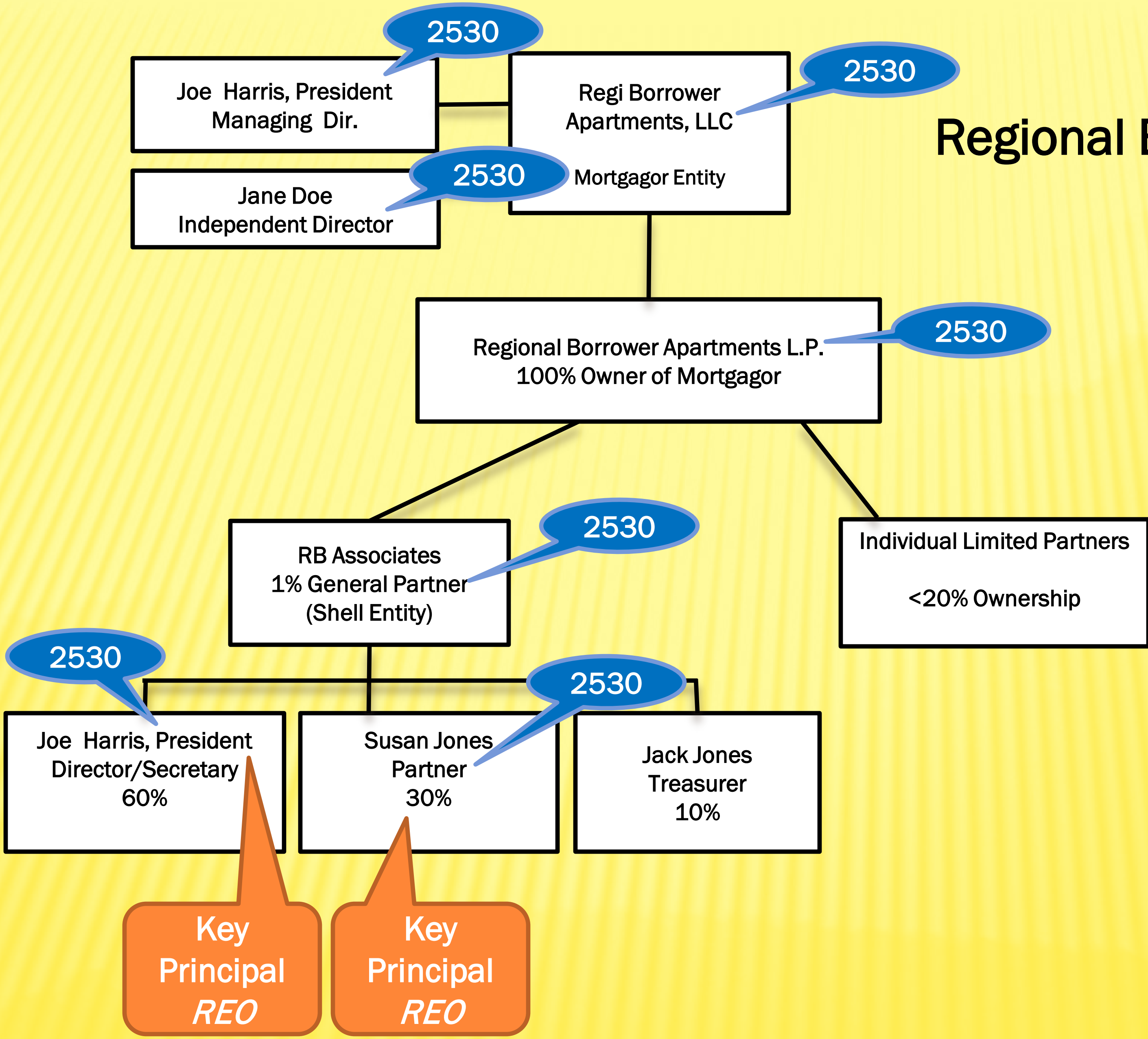
Typical large borrower entity



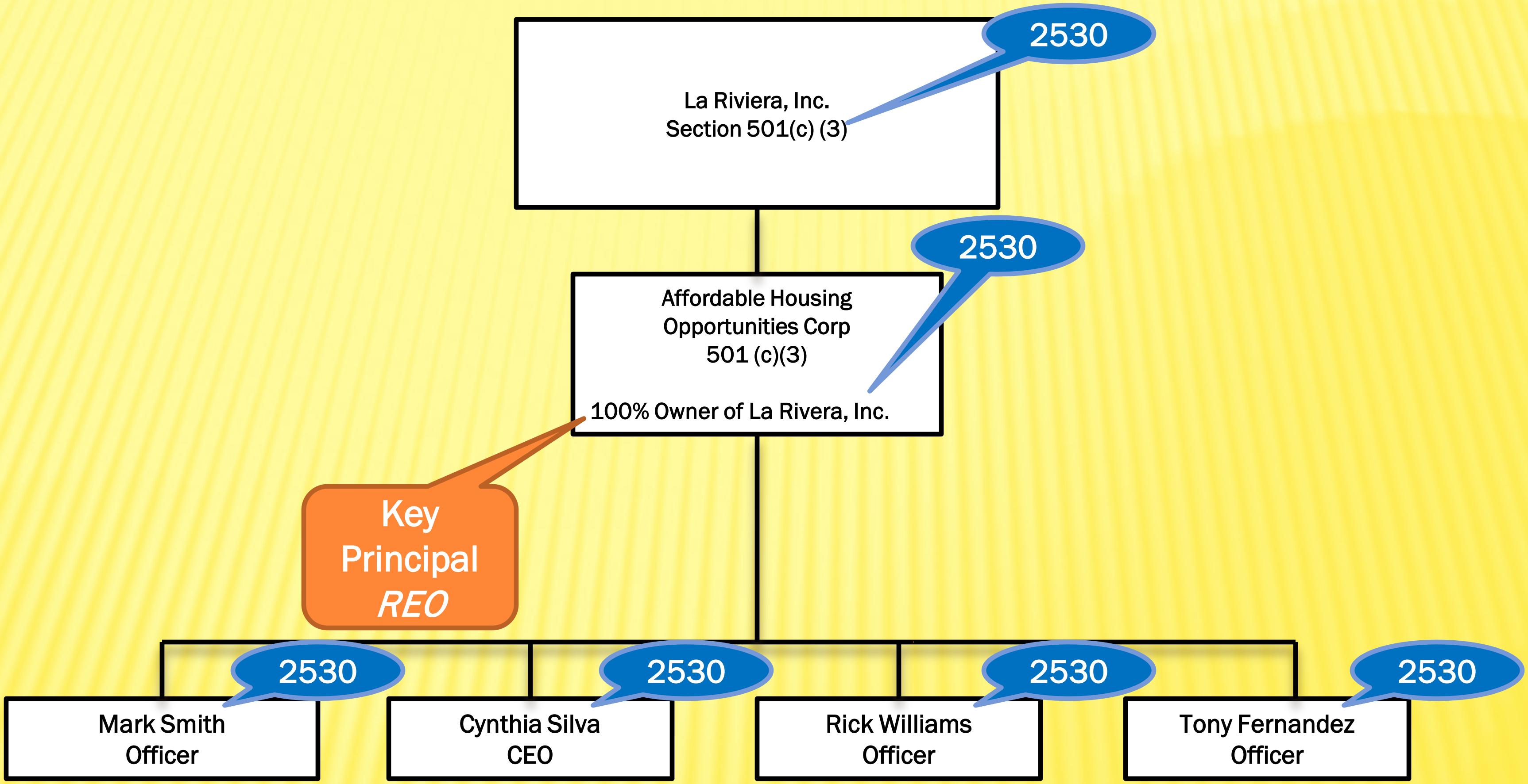
Regional Borrower v1



Regional Borrower v2



Non Profit Borrower



Introduction to the new HUD Schedule of Real Estate Owned

Why is the REO Schedule Important?

- Principals may have distressed real estate that could materially impact their financial position.
- In this environment of tighter underwriting, higher cap rates, and declining NOIs, over-leveraged assets with near-term debt maturities are a bigger risk.
- The REO Schedule reveals the borrower's concentration of real estate risk (e.g. multifamily, assisted living, new construction vs. stabilized properties, commercial, office, undeveloped land, etc.)
- This risk may be overly concentrated in certain geographic areas or markets.
- Generally, the REO Schedule lends credibility to asset values reported on the Principal's balance sheet by requiring detailed information on each real estate asset.
  - *Serves as a cross-check to balance sheet.*
- It can be used to calculate a Principal's net annual cash flow – an important measure of future liquidity.

Completing the New Schedule of Real Estate Owned

- Review all properties with near-term maturing debt to identify any refinance issues. If there are potential problem loans, does the Principal have a plan? Are there other sources available?

- Is there any recourse debt? If so, is it full recourse or partial recourse? If partial recourse, the dollar amount should be quantified.

- Be cognizant of obtaining an effective date and/or time period for the information reported in the REO Schedule. All dates should be consistent with the Balance Sheet.

- REO Schedule amounts should <u>reasonably</u> tie to the Balance Sheet amounts.

- Borrowers may have varying levels of sophistication, staff resources, and actual experience in completing a detailed REO Schedule.
  - Be patient with the request, and realize it may require more interaction from Lender to obtain accurate information from the borrower. Some challenges may arise as practice vs. theory doesn't always match up perfectly!

Overview of REO Schedule Column Categories: Ownership Role & Percentage

- Is the Principal a General Partner or Managing Member, Sole Shareholder, Limited Partner?

- What is the Principal's ownership interest percentage (profit and loss sharing %)?
  - *This is needed to calculate the equity ownership and the percentage of net cash flow to the Principal.*

Overview of REO Schedule Column Categories: Current Physical Occupancy

- Realize that this is typically a occupancy at a point in time, and not an average over time.

- Occupancy figure may not be current. Lender needs the most current figure available.

- Low occupancy may indicate property is in lease-up, under rehab, or in a soft market.
  - *Lender follow-up may be needed to obtain reasons for low occupancy level and/or current status of project.*

- Any and all unusual or inexplicable occurrences should be investigated further.
  - Negative: Low occupancy and high reported DSCR may suggest a property in lease-up . Or debt service is interest-only.
  - Positive: Maybe it’s a property with low leverage.

Overview of REO Schedule Column Categories: Analysis of Current Debt

<u>Existing Mortgages</u>

- Lender should list separately the unpaid balance of each mortgage secured by the property, 1^{st}, 2^{nd}, 3^{rd},…

<u>Type of Mortgage</u>

- Describe amortization.
  - *Fully amortizing or balloon?*
- Fixed or variable rate?
- If floating rate loan, describe.
  - What is the index and margin?
  - How often does it reset?
  - Interest rate cap?
- Is it still on a construction loan (interest-only) or mini-perm?

Overview of REO Schedule Column Categories:
NOI Analysis

Annual Effective Gross Rental & Commercial Income

- Must be actual, not the project's budgeted income, for the most recent time period.

Annual Operating Expenses

- Should reflect all property fixed and variable costs including management fee and reserves for replacement.
- If owner-managed, Lender may need to impute reserves or market management fee.

Annual Net Income

- To be useful, Effective Gross Income and Operating Expenses must be accurate.
  - *Essential that Annual Net Income is reliable for use in calculating LTV, DSCR and Equity calculations.*

Overview of REO Schedule Column Categories: Selecting a Cap rate

Current Cap Rate Assumption

- Lender may accept or reject cap rate assumptions provided by Principal.
- Most Principals are very knowledgeable on cap rates for the markets they invest in.
  - *Lender should not presume cap rates are too low.*
- Accept some; reject others. Accept all; reject all.
  - *If a reported cap rate appears overly conservative, may want to simply accept it as stated.*
- Lender may want to review third-party broker surveys or in-house files.
- Cap rate adjustments will impact the Principal's reported net worth.
- Cap rate not appropriate for certain assets. Principal may value these assets based on recent appraisals, broker interviews, personal knowledge, or even historical cost.
  - Undeveloped Land.
  - Construction in progress.
  - Single family rental homes, 1-4 unit rental properties.

Overview of REO Schedule Column Categories: Calculating Market Value

Present Market Value

- Derived by capitalizing Net Income using cap rates Lender has selected.
  - Borrower provided.
  - Lender’s experience.
  - Lender imputed.

- Value may reflect appropriate alternative method in lieu of capitalizing income.

- Be alert to values that don’t appear to reflect current Fair Market Value.
  - Reported at historical cost and may needs up or down adjustment.
  - Bad or overly aggressive value estimates from Principal.
  - Lenders proper bias toward conservative presentation.

Overview of REO Schedule Column Categories: Calculating LTV and Equity

<u>LTV Ratio</u>

- Assuming typical fixed rate amortizing loans for MF properties, there should generally be an inverse relationship between the LTV and DSCR. Interest-only or floating rate payment structures may reflect both high DSCR and LTV.

- Unusual relationships may surface questions as to accuracy of other items. Further investigation may be needed.

<u>Current Equity</u>

- Market Value x Ownership %
  <u>Less: Total mortgage debt x Ownership %</u>
  Current Equity

- Should be able to cross-check Equity value between the REO Schedule and the Balance Sheet.

Overview of REO Schedule Column Categories:
Calculating Annual Debt Service

Annual Debt Service

- Should reflect Principal + Interest payment ONLY.

- Obvious to Lenders but not always to Principals - debt service payments should exclude any required impounds for reserves, taxes, insurance, and/or other escrows.

- Be alert to possible interest-only payments on construction loans, permanent loans with an IO period, and floating rate debt.

- Lender must stress test each asset’s refinancing risk using fixed market rates and amortization, etc.

- Payments, Current Mortgage Balance, and Maturity Date should flow from and tie to the new **Attachment B – Business Debt Schedule.**

Overview of REO Schedule Column Categories: Calculating Debt Service Coverage Ratio

Debt Service Coverage Ratio (DSCR)

- Items to Consider:
  - Abnormally high DSCR may be indicative of interest-only loan or floating rate payments.
  - Abnormally low DSCR may indicate: lease-up; renovation; construction; management turnover; poor management; physical needs issue; soft market; too much debt; other external factor, etc.
- In other words, low DSCRs may not all tell the same story.
- If various types of loans are present, may need to normalize Annual Debt Service for a more accurate DSCR on individual assets and the portfolio as a whole.

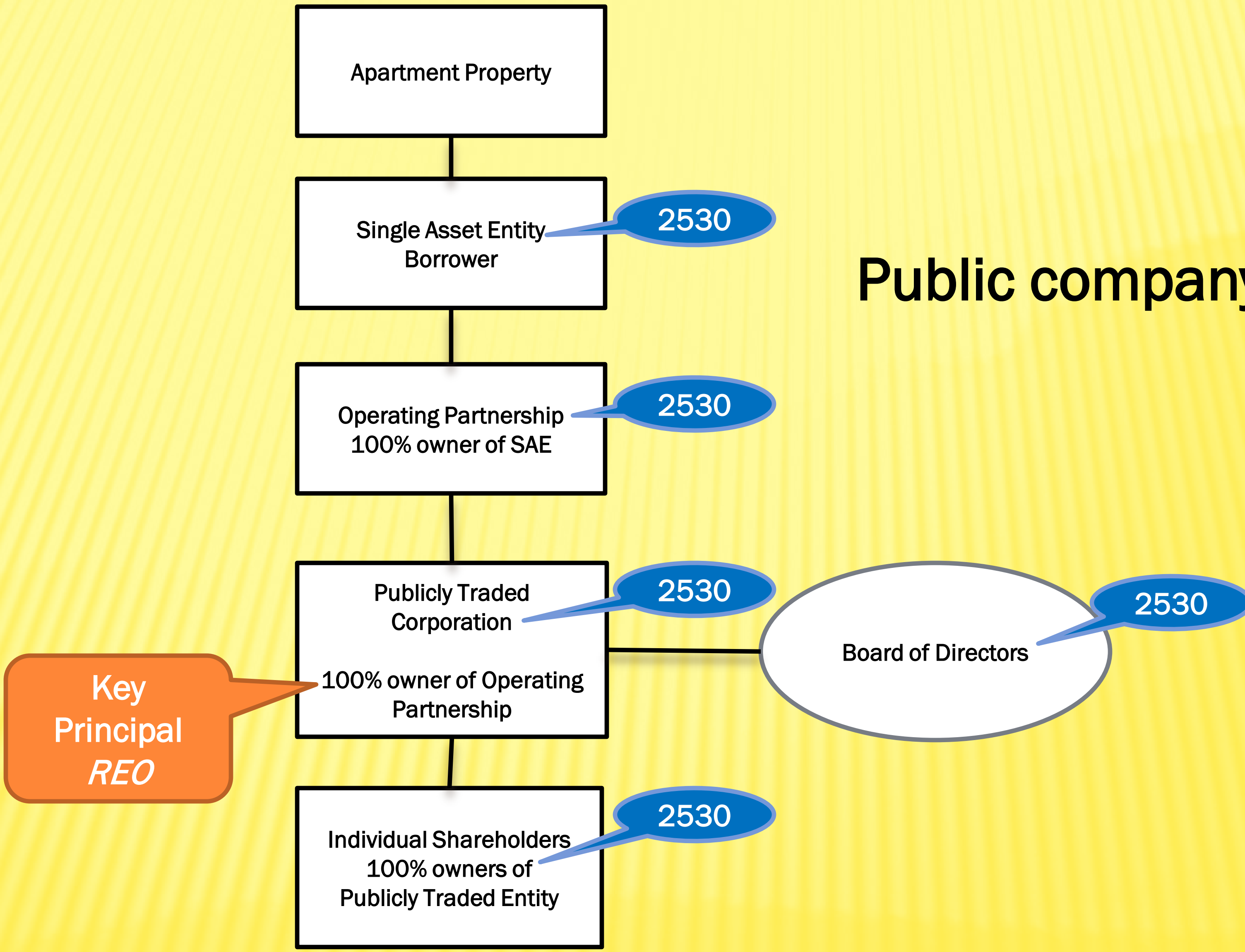
Overview of REO Schedule Column Categories: Pending Actions and Claims

Pending Judgments, Legal Suit/Actions, or Bankruptcy Claims

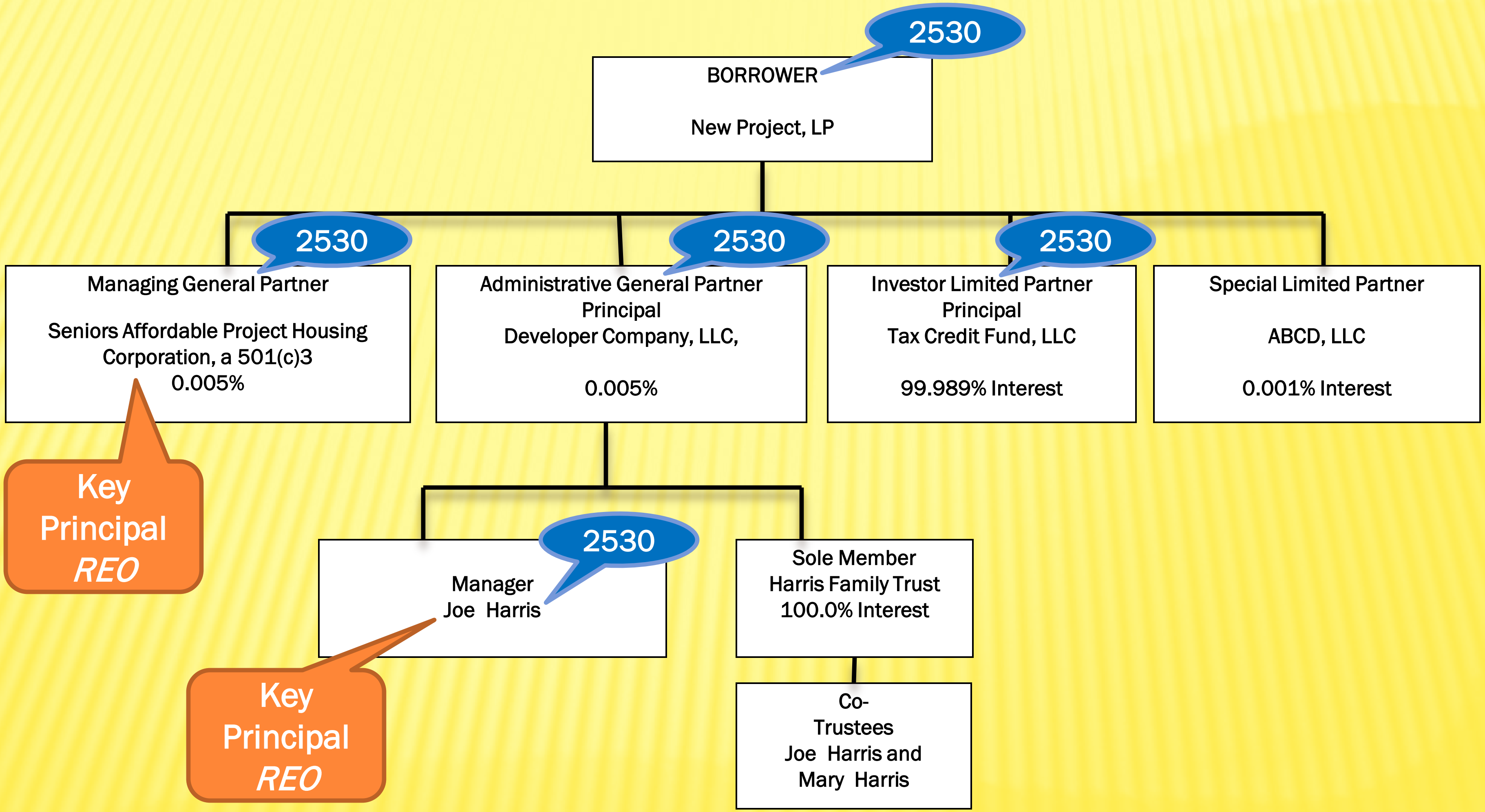
If "Yes" then obtain:

A detailed written statement should be obtained providing relevant explanation as to the cause and resolution, or current status, of pending judgments, active legal actions, bankruptcy claims, delinquencies, defaults, foreclosures, or deeds-in-lieu of foreclosure. This statement should be signed and dated by the Principal.

Public company



LIHTC Borrower Structure



Lender Analysis of REO Schedule

Cathy Pharis

- Lender needs to provide analysis of the information found on the developer's REO Schedule
- Identify projects of concern
- Determine if owner values are reasonably valid
- Identify maturing debt and make conclusions as to refinance feasibility
- Identify loans "under water"
- Determine overall health of the portfolio
- Compare REO schedule to principal's financial statements
- Make affirmative recommendation to HUD on credit worthiness of principal

Be Sure NOI and Debt Service provided by Borrower are accurate

- NOI should be before payments for debt service
- Debt service payment should NOT include escrows for taxes, insurance, etc., but should include MIP if the loan is HUD-insured
- Following slides will use Project #4 from Regional Borrower REO as example project

- Imputed Equity is calculated as:
  - (Value – Mortgage) x Principal's % Ownership
  - ($16,718,443 - $13,130,000) x 0.875% = $31,399 in example
  - Lender makes calculation on entire REO portfolio and may adjust Borrower's financial statement conclusions accordingly

- Determine Lender's Loan to Value
  - Current debt divided by Lender's Value conclusion
  - $13,130,000 / $16,718,443 or 79% in example
  - Look at Lender's LTV determination in considering refinancing capabilities of project

- Borrower’s NOI divided by Borrower’s Value = Imputed Borrower Cap Rate

- Example Using Project 4:
  - $1,170,291 Net Operating Income
  - $19,500,000 Value per REO Schedule
  - NOI / Value = 6.0% cap rate per Borrower

- Lender determines current valid cap rate for product type
  - May require discussion with appraisers
  - If subject property, look at appraisal!

- Apply Lender Cap Rate to NOI
  - In example Lender determined cap rate of 7.0%
  - Applying 7% cap rate results in value of $16,718,443
  - Lender value is below owner value of $19,500,000

- Lender makes own rough calculation as to Principal's Imputed Equity in Real Estate and compares to Principal's estimate and financial statements.

- Determine project cashflow based upon current debt
    - NOI minus debt service = project cashflow

- Determine principal's share of cashflow
    - Total project cashflow x principal's ownership share
    - $398,174 x 0.875% = $3,484 in example

- Determine overall cashflow going to Principal to consider overall portfolio health
    - Remember that cashflow of portfolio is not an indication of refinancing capability of maturing debt

- Discussion of Organizational Structure and how Lender determined who "Principals" are for purposes of REO Schedules

  - Who are the decision makers?
  - Who are the monied partners?

- REO Schedules for each Principal

  - May require back and forth with Principals to assure appropriately completed
  - Indicate time period for which information is provided (e.g., Information is as of June 30, 2010 and represents six months of annualized operations)

- Lender Mathematical Analysis of REO Schedule
  - Lender analysis of portfolio valuations
  - Lender analysis of ability to refinance ballooning transaction
  - Lender analysis of portfolio cashflow to Principal

- Lender Written Analysis of Portfolio
  - Recommend inclusion of brief write-up on each transaction depending on volume of deals on REO schedule
  - On assets that require explanation, provide DETAILED written analysis of the project, the Borrower’s expectations as to how it will be handled, and why Lender believes that outcome is acceptable
  - Discuss overall portfolio results and relate it to the financial statements

- Lender’s Recommendation
  - Discuss both character and financial strength of each Principal
  - May be complementary information that results in a positive recommendation, such as one Principal with financial strength combined with a decision maker who is less strong financially but has excellent experience in the real estate type contemplated.
  - It is much easier to mitigate financial weakness with additional Principals than it is to mitigate character weakness.
  - Weak credit is NOT offset by more conservative loan underwriting

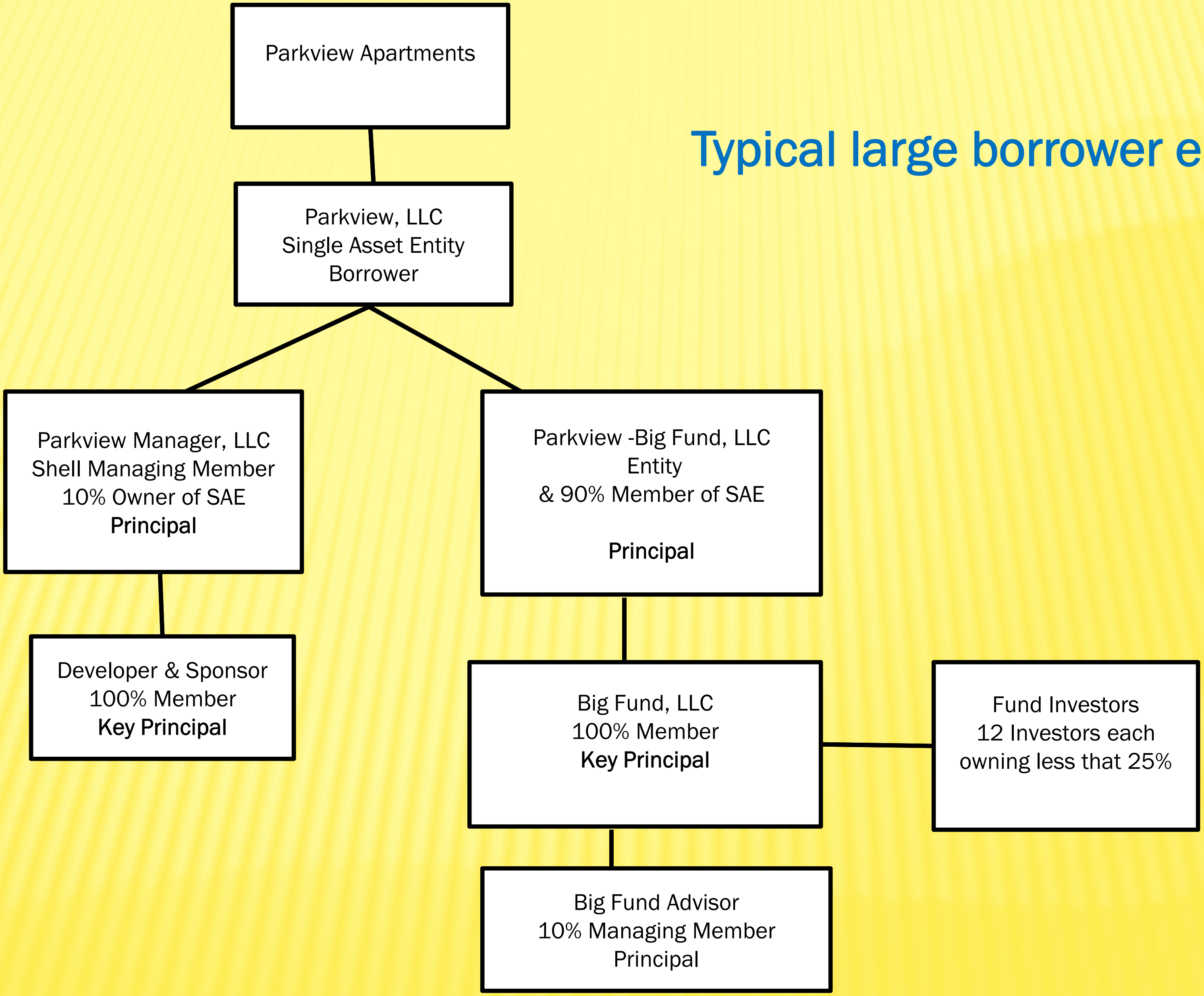
SCHEDULE OF REAL ESTATE HOLDINGS

Borrower's Name (Borrower Principal Name) & the Proposed Project Name____

Borrower/ Borrower Principal Name #1 (Owner(s) of property (include all legal and beneficial owners)) One schedule for each Borrower

Property Name & Address	Type of Property & # of Units	Year Built	Acquisition Date of Property	Ownership Role & Percentage %	Current Physical Occupancy %	Annual Net Income (NOI, including R4R deposits and mgt fee)	Present Market Value	Existing Amount of Mortgages (and Liens) List each lien separately if multiple liens exist	Date mortgage originated	Type of mortgage - fully amortizing, balloon payment, or (if floating rate) date of interest rate reset	Maturity date (or date of balloon or interest rate reset)	LTV Ratio	Current Equity (% x Mkt Value - Existing Indebtedness)	Annual Effective Gross Rental & Commercial Income (after concessions and vacancy loss)	Annual Operating Expenses	Annual Debt Service	Debt Service Coverage Ratio	Pending Judgments, Legal Suits/Actions or Bankruptcy Claims
Elm Apts Phoenix, AZ	**300**	**1986**	**2005**	**General Partner 3.0%**	**82%**	**$ 1,060,574**	**$ 21,000,000**	**$ 13,189,000**	**2005**	**Balloon Fixed**	**2015**	**62.8%**	**$ 234,330**	**$ 1,870,501**	**$ 809,927**	**$ 883,790**	**1.20**	**None**
Beech Apts Phoenix, AZ	368	1986	2005	General Partner 5.0%	87%	$ 1,315,786	$ 24,000,000	$ 16,602,000	2005	Balloon Fixed	2015	69.2%	$ 369,900	$ 2,396,696	$ 1,080,910	$ 1,056,892	1.24	None
Oak Apts Tucson, AZ	**301**	**1970**	**2005**	**General Partner 1.0%**	**88%**	**$ 986,675**	**$ 10,800,000**	**$ 10,000,000**	**2005**	**Fully Amort**	**2035**	**92.6%**	**$ 8,000**	**$ 1,641,722**	**$ 655,047**	**$ 883,790**	**1.12**	**Tenant Lawsuits**
Cactus Apts Tucson, AZ	103	1988	2007	Managing Member 6.0%	90%	$ 306,057	$ 4,081,000	$ 3,150,000	2007	Balloon Fixed	2017	77.2%	$ 55,860	$ 516,116	$ 210,059	$ 208,733	1.47	Tenant Lawsuits
Palm Apts Los Angeles, CA	**201**	**1990**	**2003**	**General Partner 50.0%**	**96%**	**$ 1,216,913**	**$ 21,559,000**	**$ 12,706,661**	**2003**	**Balloon Variable**	**2010**	**58.9%**	**$ 4,426,170**	**$ 1,889,616**	**$ 672,703**	**$ 422,098**	**2.88**	**None**
Pine Apts San Diego, CA	288	1978	2006	Managing Member 3.0%	95%	$ 2,379,982	$ 31,733,000	$ 20,078,796	2006	Balloon Fixed	2013	63.3%	$ 349,626	$ 3,736,235	$ 1,356,253	$ 1,634,112	1.46	None
Fir Apts Bakersfield, CA	322	1982	2007	Managing Member 1.0%	85%	$ 2,705,293	$ 36,071,000	$ 20,548,352	2007	Balloon Fixed	2012	57.0%	$ 155,226	$ 5,037,790	$ 2,332,497	$ 1,672,236	1.62	None
Aspen Apts Fresno, CA	246	1996	2007	Managing Member 10.0%	93%	$ 1,279,243	$ 22,299,000	$ 11,694,988	2007	Balloon Variable	2027	52.4%	$ 1,060,401	$ 2,240,356	$ 961,113	$ 563,185	2.27	Contractor lien & lawsuit
Ash Apts Los Angeles, CA	192	1996	2005	General Partner 5.0%	92%	$ 1,996,281	$ 26,617,000	$ 23,182,000	2005	Fully Amort	2035	87.1%	$ 171,750	$ 3,204,303	$ 1,208,022	$ 1,179,964	1.69	None
Redwood Apts Portland, OR	256	1993	2005	General Partner 2.0%	94%	$ 1,616,404	$ 30,885,000	$ 13,236,453	2005	Fully Amort	2035	42.9%	$ 352,971	$ 2,786,903	$ 1,170,499	$ 1,141,304	1.42	None
Magnolia Apts Portland, OR	102	1998	2006	Managing Member 50.0%	94%	$ 411,104	$ 5,481,000	$ 3,307,520	2006	Fully Amort	2036	60.3%	$ 1,086,740	$ 732,806	$ 321,702	$ 266,130	1.54	None
Olive Apts Fresno, CA	88	1985	2006	Managing Member 3.0%	90%	$ 240,000	$ 3,200,000	$ 1,000,000	2006	Balloon Int Only	2011	31.3%	$ 66,000	$ 403,361	$ 163,361	$ 100,000	2.40	None
Cedar Apts Seattle, WA	180	1990	2005	General Partner 4.0%	88%	$ 795,534	$ 10,607,000	$ 6,450,635	2005	Balloon Fixed	2015	60.8%	$ 166,255	$ 1,297,772	$ 502,238	$ 546,000	1.46	None
Maple Apts San Diego, CA	212	1987	2004	General Partner 33.0%	94%	$ 1,202,734	$ 16,036,000	$ 8,924,517	2004	Balloon Fixed	2014	55.7%	$ 2,346,789	$ 2,231,417	$ 1,028,683	$ 754,332	1.59	None
Birch Apts San Diego, CA	312	1983	2004	General Partner 33.0%	99%	$ 1,301,928	$ 17,359,000	$ 13,000,000	2004	Balloon Fixed	2014	74.9%	$ 1,438,470	$ 2,375,781	$ 1,073,853	$ 1,120,369	1.16	None
Willow Apts Las Vegas, NV	**376**	**1980**	**2005**	**General Partner 1.0%**	**76%**	**$ 1,977,038**	**$ 30,700,000**	**$ 21,411,000**	**2005**	**Fully Amort**	**2035**	**69.7%**	**$ 92,890**	**$ 3,505,387**	**$ 1,528,349**	**$ 1,851,906**	**1.07**	**Tax Appeal**
Locust Apts Las Vegas, NV	336	1995	2005	General Partner 1.0%	88%	$ 1,773,196	$ 34,703,000	$ 20,785,000	2005	Balloon Fixed	2015	59.9%	$ 139,180	$ 3,015,639	$ 1,242,443	$ 1,418,557	1.25	None
Cherry Apts Las Vegas, NV	288	1996	2006	Managing Member 1.0%	89%	$ 1,295,147	$ 17,935,000	$ 13,625,000	2006	Balloon Fixed	2016	76.0%	$ 43,100	$ 2,256,354	$ 961,207	$ 1,189,656	1.09	None
Chestnut Apts Las Vegas, NV	108	1998	2007	Managing Member 1.0%	86%	$ 467,401	$ 7,000,000	$ 5,588,000	2007	Fully Amort	2037	79.8%	$ 14,120	$ 812,871	$ 345,470	$ 355,680	1.31	None
Totals				0%	$0	$24,327,290		$238,479,922				64.1%	$12,577,778	$41,951,627	$17,624,337	$17,248,734	1.41	
							$ 372,066,000											

Typical large borrower entity



LARGE BORROWER

- Complex Ownership Structure
  - Multiple “Key” Principals
  - Drill through Principal layers
- Developer provides real estate expertise
- Developer typically doesn’t have enough financial strength itself to be sole “Key” Principal
- Money Partner provides financial strength
  - Parkview-Big Fund, LLC is subset of Big Fund, LLC
  - Mortgage Credit Review of Big Fund, LLC
  - Big Fund Advisor has limited financial strength, but has control of Big Fund
  - Big Fund Investors are passive and do not have control

SCHEDULE OF REAL ESTATE HOLDINGS

Borrower's Name (Borrower Principal Name) & the Proposed Project Name____

Borrower/ Borrower Principal Name #1 (Owner(s) of property (include all legal and beneficial owners)) One schedule for each Borrower

Property Name & Address	Type of Property & # of Units	Year Built	Acquisition Date of Property	Ownership Role & Percentage %	Current Physical Occupancy %	Annual Net Income (NOI, including R4R deposits and mgt fee)	Present Market Value	Existing Amount of Mortgages (and Liens) List each lien separately if multiple liens exist	Date mortgage originated	Type of mortgage - fully amortizing, balloon payment, or (if floating rate) date of interest rate reset	Maturity date (or date of balloon or interest rate reset)	LTV Ratio	Current Equity (% x Mkt Value - Existing Indebtedness)	Annual Effective Gross Rental & Commercial Income (after concessions and vacancy loss)	Annual Operating Expenses	Annual Debt Service	Debt Service Coverage Ratio	Pending Judgments, Legal Suits/Actions or Bankruptcy Claims
Elm Apts Phoenix, AZ	**300**	**1986**	**2005**	**General Partner 3.0%**	**82%**	**$ 1,060,574**	**$ 21,000,000**	**$ 13,189,000**	**2005**	**Balloon Fixed**	**2015**	**62.8%**	**$ 234,330**	**$ 1,870,501**	**$ 809,927**	**$ 883,790**	**1.20**	**None**
Beech Apts Phoenix, AZ	368	1986	2005	General Partner 5.0%	87%	$ 1,315,786	$ 24,000,000	$ 16,602,000	2005	Balloon Fixed	2015	69.2%	$ 369,900	$ 2,396,696	$ 1,080,910	$ 1,056,892	1.24	None
Oak Apts Tucson, AZ	**301**	**1970**	**2005**	**General Partner 1.0%**	**88%**	**$ 986,675**	**$ 10,800,000**	**$ 10,000,000**	**2005**	**Fully Amort**	**2035**	**92.6%**	**$ 8,000**	**$ 1,641,722**	**$ 655,047**	**$ 883,790**	**1.12**	**Tenant Lawsuits**
Cactus Apts Tucson, AZ	103	1988	2007	Managing Member 6.0%	90%	$ 306,057	$ 4,081,000	$ 3,150,000	2007	Balloon Fixed	2017	77.2%	$ 55,860	$ 516,116	$ 210,059	$ 208,733	1.47	Tenant Lawsuits
Palm Apts Los Angeles, CA	**201**	**1990**	**2003**	**General Partner 50.0%**	**96%**	**$ 1,216,913**	**$ 21,559,000**	**$ 12,706,661**	**2003**	**Balloon Variable**	**2010**	**58.9%**	**$ 4,426,170**	**$ 1,889,616**	**$ 672,703**	**$ 422,098**	**2.88**	**None**
Pine Apts San Diego, CA	288	1978	2006	Managing Member 3.0%	95%	$ 2,379,982	$ 31,733,000	$ 20,078,796	2006	Balloon Fixed	2013	63.3%	$ 349,626	$ 3,736,235	$ 1,356,253	$ 1,634,112	1.46	None
Fir Apts Bakersfield, CA	322	1982	2007	Managing Member 1.0%	85%	$ 2,705,293	$ 36,071,000	$ 20,548,352	2007	Balloon Fixed	2012	57.0%	$ 155,226	$ 5,037,790	$ 2,332,497	$ 1,672,236	1.62	None
Aspen Apts Fresno, CA	246	1996	2007	Managing Member 10.0%	93%	$ 1,279,243	$ 22,299,000	$ 11,694,988	2007	Balloon Variable	2027	52.4%	$ 1,060,401	$ 2,240,356	$ 961,113	$ 563,185	2.27	Contractor lien & lawsuit
Ash Apts Los Angeles, CA	192	1996	2005	General Partner 5.0%	92%	$ 1,996,281	$ 26,617,000	$ 23,182,000	2005	Fully Amort	2035	87.1%	$ 171,750	$ 3,204,303	$ 1,208,022	$ 1,179,964	1.69	None
Redwood Apts Portland, OR	256	1993	2005	General Partner 2.0%	94%	$ 1,616,404	$ 30,885,000	$ 13,236,453	2005	Fully Amort	2035	42.9%	$ 352,971	$ 2,786,903	$ 1,170,499	$ 1,141,304	1.42	None
Magnolia Apts Portland, OR	102	1998	2006	Managing Member 50.0%	94%	$ 411,104	$ 5,481,000	$ 3,307,520	2006	Fully Amort	2036	60.3%	$ 1,086,740	$ 732,806	$ 321,702	$ 266,130	1.54	None
Olive Apts Fresno, CA	88	1985	2006	Managing Member 3.0%	90%	$ 240,000	$ 3,200,000	$ 1,000,000	2006	Balloon Int Only	2011	31.3%	$ 66,000	$ 403,361	$ 163,361	$ 100,000	2.40	None
Cedar Apts Seattle, WA	180	1990	2005	General Partner 4.0%	88%	$ 795,534	$ 10,607,000	$ 6,450,635	2005	Balloon Fixed	2015	60.8%	$ 166,255	$ 1,297,772	$ 502,238	$ 546,000	1.46	None
Maple Apts San Diego, CA	212	1987	2004	General Partner 33.0%	94%	$ 1,202,734	$ 16,036,000	$ 8,924,517	2004	Balloon Fixed	2014	55.7%	$ 2,346,789	$ 2,231,417	$ 1,028,683	$ 754,332	1.59	None
Birch Apts San Diego, CA	312	1983	2004	General Partner 33.0%	99%	$ 1,301,928	$ 17,359,000	$ 13,000,000	2004	Balloon Fixed	2014	74.9%	$ 1,438,470	$ 2,375,781	$ 1,073,853	$ 1,120,369	1.16	None
Willow Apts Las Vegas, NV	**376**	**1980**	**2005**	**General Partner 1.0%**	**76%**	**$ 1,977,038**	**$ 30,700,000**	**$ 21,411,000**	**2005**	**Fully Amort**	**2035**	**69.7%**	**$ 92,890**	**$ 3,505,387**	**$ 1,528,349**	**$ 1,851,906**	**1.07**	**Tax Appeal**
Locust Apts Las Vegas, NV	336	1995	2005	General Partner 1.0%	88%	$ 1,773,196	$ 34,703,000	$ 20,785,000	2005	Balloon Fixed	2015	59.9%	$ 139,180	$ 3,015,639	$ 1,242,443	$ 1,418,557	1.25	None
Cherry Apts Las Vegas, NV	288	1996	2006	Managing Member 1.0%	89%	$ 1,295,147	$ 17,935,000	$ 13,625,000	2006	Balloon Fixed	2016	76.0%	$ 43,100	$ 2,256,354	$ 961,207	$ 1,189,656	1.09	None
Chestnut Apts Las Vegas, NV	108	1998	2007	Managing Member 1.0%	86%	$ 467,401	$ 7,000,000	$ 5,588,000	2007	Fully Amort	2037	79.8%	$ 14,120	$ 812,871	$ 345,470	$ 355,680	1.31	None
Totals				0%	$0	$24,327,290		$238,479,922				64.1%	$12,577,778	$41,951,627	$17,624,337	$17,248,734	1.41	
							$ 372,066,000											

GENERAL OBSERVATIONS OF REO SCHEDULE

- Geographic distribution
  - Western US
- Age of Properties
  - Range from 1970-2007
- Role in Ownership
  - Controlling Minority Owner
- Acquisition dates
  - Active buyer
  - Steady Activity
  - Impact on Maturity Schedule

MATURITY SCHEDULE

Year	No. of Loans	Unpaid Principal Bal.	% of UPB
2010	1	$ 12,706,661	5.3%
2011	1	$ 1,000,000	0.4%
2012	1	$ 20,548,352	8.6%
2013	1	$ 20,078,796	8.4%
2014	2	$ 21,924,517	9.2%
2015	4	$ 57,026,635	23.9%
After 2015	3	$ 28,469,988	11.9%
Fully Amortizing	6	$ 76,724,973	32.2%
Total		$ 238,479,922	100.0%

OVERVIEW OF LOAN TERMS

- Loan Terms
  - Various loan terms of 5-30 years
  - 32% of Portfolio is Fully Amortizing
  - Staggered Loan Maturities
    - 2015 heaviest year for maturities
- Largely Fixed Interest Rates
  - Two Variable Rate Deals
    - Need terms of how interest rate adjusts
    - Any Interest rate hedges (Caps or Swaps)

OVERVIEW OF LEVERAGE

- Overall reported leverage of 64%
- Range of LTV is 31% to 93%
- What is basis of Valuation?
  - Cost basis
  - Borrower Estimate
  - Third Party Value
- What is Implied Cap Rate?
  - How does Cap Rate compare to Market/Appraisal

Supplementary Schedule #1 - General

Property Name & Address	Expense Ratio	Implied Cap Rate	Implied Mortgage Constant
Elm Apts **Phoenix, AZ**	**43.3%**	**5.1%**	**6.70%**
Beech Apts Phoenix, AZ	45.1%	5.5%	6.37%
Oak Apts **Tucson, AZ**	**39.9%**	**9.1%**	**8.84%**
Cactus Apts Tucson, AZ	40.7%	7.5%	6.63%
Palm Apts **Los Angeles, CA**	**35.6%**	**5.6%**	**3.32%**
Pine Apts San Diego, CA	36.3%	7.5%	8.14%
Fir Apts Bakersfield, CA	46.3%	7.5%	8.14%
Aspen Apts Fresno, CA	42.9%	5.7%	4.82%
Ash Apts Los Angeles, CA	37.7%	7.5%	5.09%
Redwood Apts Portland, OR	42.0%	5.2%	8.62%
Magnolia Apts Portland, OR	43.9%	7.5%	8.05%
Olive Apts Fresno, CA	40.5%	7.5%	10.00%
Cedar Apts Seattle, WA	38.7%	7.5%	8.46%
Maple Apts San Diego, CA	46.1%	7.5%	8.45%
Birch Apts San Diego, CA	45.2%	7.5%	8.62%
Willow Apts **Las Vegas, NV**	**43.6%**	**6.4%**	**8.65%**
Locust Apts Las Vegas, NV	41.2%	5.1%	6.82%
Cherry Apts Las Vegas, NV	42.6%	7.2%	8.73%
Chestnut Apts Las Vegas, NV	42.5%	6.7%	6.37%

LEVERAGE - INDIVIDUAL PROPERTIES

- Oak Apartment - 93% LTV Reported
  - Fully Amortizing
  - Positive cash flow
  - Implied Cap rate of 9.1%
- Elm Apartment – 63% LTV Reported
  - Maturity Date in 2015
  - Implied Cap of 5.1%
  - Estimated Market LTV of 87%

Supplementary Schedule #2 - LTV Comparison

Property Name & Address	Market Cap Rate	Reported LTV	Market Value LTV	Delta in DSCR
Elm Apts Phoenix, AZ	**$ 15,151,057**	**62.8%**	**87.1%**	**24.2%**
Beech Apts Phoenix, AZ	$ 18,796,943	69.2%	88.3%	19.1%
Oak Apts Tucson, AZ	**$ 14,095,357**	**92.6%**	**70.9%**	**-21.6%**
Cactus Apts Tucson, AZ	$ 4,372,243	77.2%	72.0%	-5.1%
Palm Apts Los Angeles, CA	**$ 17,384,471**	**58.9%**	**73.1%**	**14.2%**
Pine Apts San Diego, CA	$ 33,999,743	63.3%	59.1%	-4.2%
Fir Apts Bakersfield, CA	$ 38,647,043	57.0%	53.2%	-3.8%
Aspen Apts Fresno, CA	$ 18,274,900	52.4%	64.0%	11.5%
Ash Apts Los Angeles, CA	$ 28,518,300	87.1%	81.3%	-5.8%
Redwood Apts Portland, OR	$ 23,091,486	42.9%	57.3%	14.5%
Magnolia Apts Portland, OR	$ 5,872,914	60.3%	56.3%	-4.0%
Olive Apts Fresno, CA	$ 3,428,571	31.3%	29.2%	-2.1%
Cedar Apts Seattle, WA	$ 11,364,771	60.8%	56.8%	-4.1%
Maple Apts San Diego, CA	$ 17,181,914	55.7%	51.9%	-3.7%
Birch Apts San Diego, CA	$ 18,598,971	74.9%	69.9%	-5.0%
Willow Apts Las Vegas, NV	**$ 28,243,400**	**69.7%**	**75.8%**	**6.1%**
Locust Apts Las Vegas, NV	$ 25,331,371	59.9%	82.1%	22.2%
Cherry Apts Las Vegas, NV	$ 18,502,100	76.0%	73.6%	-2.3%
Chestnut Apts Las Vegas, NV	$ 6,677,157	79.8%	83.7%	3.9%
Totals	$ 347,532,714	64.1%	68.6%	4.5%

OVERVIEW OF CASH FLOW

- Overall Portfolio DSCR of 1.41x
- Range of Debt Coverage is 1.07x to 2.88x
- Are any transactions below breakeven today?
- Was NOI correctly calculated?
- What is implied mortgage constant?
  - Compare implied constant to market levels
- Any Interest Only mortgages?

Supplementary Schedule #3 - DSCR Comparison

Property Name & Address	Annual Debt Service based Market Interest Rate with 30 year amort	Reported DSCR	Market Interest Rate DSCR	Delta in DSCR
Elm Apts Phoenix, AZ	**$ 948,897**	**1.20**	**1.12**	**-0.08**
Beech Apts Phoenix, AZ	$ 1,194,449	1.24	1.10	-0.14
Oak Apts Tucson, AZ	**$ 719,461**	**1.12**	**1.37**	**0.25**
Cactus Apts Tucson, AZ	$ 226,630	1.47	1.35	-0.12
Palm Apts Los Angeles, CA	**$ 914,194**	**2.88**	**1.33**	**-1.55**
Pine Apts San Diego, CA	$ 1,444,590	1.46	1.65	0.19
Fir Apts Bakersfield, CA	$ 1,478,373	1.62	1.83	0.21
Aspen Apts Fresno, CA	$ 841,408	2.27	1.52	-0.75
Ash Apts Los Angeles, CA	$ 1,667,854	1.69	1.20	-0.49
Redwood Apts Portland, OR	$ 952,311	1.42	1.70	0.28
Magnolia Apts Portland, OR	$ 237,963	1.54	1.73	0.18
Olive Apts Fresno, CA	$ 71,946	2.40	3.34	0.94
Cedar Apts Seattle, WA	$ 464,098	1.46	1.71	0.26
Maple Apts San Diego, CA	$ 642,084	1.59	1.87	0.28
Birch Apts San Diego, CA	$ 935,299	1.16	1.39	0.23
Willow Apts Las Vegas, NV	**$ 1,540,437**	**1.07**	**1.28**	**0.22**
Locust Apts Las Vegas, NV	$ 1,495,399	1.25	1.19	-0.06
Cherry Apts Las Vegas, NV	$ 980,265	1.09	1.32	0.23
Chestnut Apts Las Vegas, NV	$ 402,035	1.31	1.16	-0.15
Totals	$ 17,157,691	1.41	1.42	0.01

CASH FLOW – INDIVIDUAL PROPERTIES

- Palm Apartments – 2.88x DSCR Reported
  - Variable Rate Debt
  - Maturity Date in 2010
  - Market Interest Rate DSCR of 1.33x
- Willow Apartments – 1.07x DSCR Reported
  - Fixed Rate
  - Fully Amortizing Loan
  - Market Interest Rate DSCR of 1.28x

MISCELLANEOUS

- Any concerns with Lawsuits?
- Does data from REO support reported Net worth report on Financial Statement?
- Can Sponsor use cash flow from one deal to support another transaction?
  - Different investors may limited Sponsor's ability to "borrow" cash flow from other deals

CONCLUSIONS

- Overall REO shows moderate leverage
- All non-recourse debt
- After Deal by Deal analysis
  - Still overall moderate leverage
  - Analysis reveals different deals to further assess
- No Material Issues noted
- REO schedule does not raise any major credit concerns

SCHEDULE OF REAL ESTATE HOLDINGS

Borrower's Name (Borrower Principal Name) & the Proposed Project Name: **Affordable Housing Opportunities Corporation / Property #6**

Borrower/ Borrower Principal Name #1 (Owner(s) of property (include all legal and beneficial owners)) One schedule for each Borrower

						Total Hard and Soft Debt									**Total Hard and Soft Debt**	**Total Hard Debt Only**	**Total Hard and Soft Debt**	**Hard Payments Only**	**Hard Payments Only**	
Property Name & Address	Type of Property & # of Units	Year Built	Acquisition Date of Property	Ownership Role & Percentage %	Current Physical Occupancy %	Existing Amount of Mortgages (and Liens) List each lien separately if multiple liens exist	Date mortgage originated	Type of mortgage - fully amortizing, balloon payment, or (if floating rate) date of interest rate reset	Maturity date (or date of balloon or interest rate reset)	Annual Effective Gross Rental & Commercial Income (after concessions and vacancy loss)	Annual Operating Expenses	Annual Net Income (NOI, including RH4 deposits and mgt fee)	Current Cap Rate Assumption	Present Market Value	LTV Ratio	LTV Ratio	Current Equity (% x Mkt Value - Existing Indebetedness)	Annual Debt Service	Debt Service Coverage Ratio	Pending Judgments, Legal Suits/Actions or Bankruptcy Claims
Property 1	Apts	1991	1990	100.0%	100.0%	875,366	See Debt Sched	Mixed	See Debt Sched	$35,524	$20,604	$14,920	7.25%	$205,793	425%	42%	($669,573)	$11,731	1.27	No
Green, CA	10																			
Property 2	Apts	1992	1991	100.0%	97.2%	2,265,384	See Debt Sched	Mixed	See Debt Sched	$90,331	$52,392	$37,939	7.25%	$523,297	433%	61%	($1,742,087)	$31,172	1.22	No
Green, CA	36																			
Property 3	Apts	1992	1991	100.0%	98.4%	3,920,482	See Debt Sched	Mixed	See Debt Sched	$306,471	$177,753	$128,718	7.25%	$1,775,421	221%	43%	($2,145,061)	$74,815	1.72	No
Green, CA	62																			
Property 4	Apts	1988	1987	100.0%	100.0%	767,478	See Debt Sched	Mixed	See Debt Sched	$112,512	$65,257	$47,255	7.25%	$651,793	118%	**100%**	($115,685)	$57,514	**0.82**	No
Green, CA	24																			
Property 5	Apts	2003	2002	100.0%	97.7%	2,446,798	See Debt Sched	Mixed	See Debt Sched	$452,331	$241,000	$211,331	7.25%	$2,914,910	84%	80%	$468,112	$130,726	1.62	No
Summers, CA	44																			
Property 6	**Apts**	**1973 &**	**1997**	**100.0%**	**96.0%**	**2,861,073**	See Debt Sched	**Mixed**	See Debt Sched	**$961,276**	**$557,540**	**$403,736**	**7.25%**	**$5,568,772**	**51%**	**51%**	**$2,707,699**	**$227,187**	**1.78**	**No**
Big City, CA	100	1985																		
Property 7	Apts	2007	2006	100.0%	95.2%	2,517,635	See Debt Sched	Mixed	See Debt Sched	$120,905	$70,125	$50,780	7.25%	$700,414	359%	0%	($1,817,221)	$0	NA	No
Green, CA	15																			
Property 8	Apts	1993	1993	100.0%	100.0%	171,708	See Debt Sched	Mixed	See Debt Sched	$31,210	$18,102	$13,108	7.25%	$180,800	95%	**84%**	$9,092	$12,935	**1.01**	No
Green, CA	4																			
Property 9	Apts	1992	1991	100.0%	94.4%	1,842,895	See Debt Sched	Mixed	See Debt Sched	$216,000	$198,088	$17,912	7.25%	$247,062	746%	**154%**	($1,595,833)	$19,052	**0.94**	No
Green, CA	36																			
Property 10	Apts	1989	1989	100.0%	100.0%	576,694	See Debt Sched	Mixed	See Debt Sched	$119,414	$69,260	$50,154	7.25%	$691,779	83%	28%	$115,085	$28,000	1.79	No
Green, CA	14																			
Property 11	Apts	2002	2000	100.0%	100.0%	2,291,400	See Debt Sched	Mixed	See Debt Sched	$127,944	$129,552	**($1,608)**	7.25%	-$22,179	-10331%	0%	($2,313,579)	$0	**NA**	No
Greensville, CA	15																			
Property 12	Sr. Apts	1979	2008	100.0%	97.5%	3,224,000	See Debt Sched	Mixed	See Debt Sched	$315,640	$179,915	$135,725	7.25%	$1,872,069	172%	71%	($1,351,931)	$40,191	3.38	No
Big City, CA	40																			
Property 13	Sr. Apts	2003	2000	100.0%	100.0%	4,343,541	See Debt Sched	Mixed	See Debt Sched	$236,729	$137,303	$99,426	7.25%	$1,371,393	317%	63%	($2,972,148)	$75,269	1.32	No
Green, CA	30																			

SCHEDULE OF REAL ESTATE HOLDINGS

Borrower's Name (Borrower Principal Name) & the Proposed Project Name: **Affordable Housing Opportunities Corporation / Property #6**

Borrower/ Borrower Principal Name #1 (Owner(s) of property (include all legal and beneficial owners)) One schedule for each Borrower

						Total Hard and Soft Debt									**Total Hard and Soft Debt**	**Total Hard Debt Only**	**Total Hard and Soft Debt**	**Hard Payments Only**	**Hard Payments Only**	
Property Name & Address	Type of Property & # of Units	Year Built	Acquisition Date of Property	Ownership Role & Percentage %	Current Physical Occupancy %	Existing Amount of Mortgages (and Liens) List each lien separately if multiple liens exist	Date mortgage originated	Type of mortgage - fully amortizing, balloon payment, or (if floating rate) date of interest rate reset	Maturity date (or date of balloon or interest rate reset)	Annual Effective Gross Rental & Commercial Income (after concessions and vacancy loss)	Annual Operating Expenses	Annual Net Income (NOI, including RH4 deposits and mgt fee)	Current Cap Rate Assumption	Present Market Value	LTV Ratio	LTV Ratio	Current Equity (% x Mkt Value - Existing Indebetedness)	Annual Debt Service	Debt Service Coverage Ratio	Pending Judgments, Legal Suits/Actions or Bankruptcy Claims
Property 14	Sr. Apts	1995	1994	100.0%	100.0%	456,958	See Debt Sched	Mixed	See Debt Sched	$128,490	$74,524	$53,966	7.25%	$744,359	61%	61%	$287,401	$38,807	1.39	No
Green, CA	12																			
Property 15	MHC	2009	2007	100.0%	93.1%	7,437,683	See Debt Sched	Mixed	See Debt Sched	$323,407	$187,576	$135,831	7.25%	$1,873,531	397%	53%	($5,564,152)	$55,188	2.46	No
Greensville, CA	155																			
Totals				100.0%	98.0%	$35,999,095				$3,578,184	$2,178,991	$1,399,193	7.25%	$19,299,214	187%	59%	($16,699,881)	$802,587	1.74	

DEBT DETAIL SCHEDULE

Borrower's Name (Borrower Principal Name) & the Proposed Project Name: **Affordable Housing Opportunities Corporation / Property #6**

	Name of Creditor	Original Date	Current Balance	Interest Rate	Maturity Date	Annual Principal Payment	Annual Interest Payment	Hard or Soft Payments	Collateral	Current or Delinquent
1	CalHFA	1991	86,912	8.26%	2021	4,354	7,376	Hard	Apartments	Current
	CHRP	1995	350,000	3.00%	2020	-	10,500	Soft	Apartments	Current
	CHRP Accrued Interest	n/a	148,344	n/a	n/a	-	-	Soft	Apartments	Current
	City of Green Housing Trust Fund	1995	245,000	0.00%	2020	-	-	Soft	Apartments	Current
	City of Green	2004	45,110	3.00%	2064	-	45	Soft	Apartments	Current
2	CDHCD Mortgage Payable	1992	962,289	3.00%	2052	-	28,869	Soft	Apartments	Current
	Accrued Interest	n/a	471,859	n/a	n/a	-	-	Soft	Apartments	Current
	City of Green Mortgage Payable	2006	394,744	0.00%	2046	-	-	Soft	Apartments	Current
	Big Bank Mortgage Payable	1994	321,271	4.25%	2024	17,121	14,051	Hard	Apartments	Current
	City of Green JUSD	1992	65,771	6.50%	2022	3,120	4,449	Soft	Apartments	Current
	City Of Green Redevelopment Agency	n/a	49,450	n/a	n/a	-	-	Soft	Apartments	Current
3	CDHCD Mortgage Payable	1992	2,079,295	3.00%	2032	-	62,379	Soft	Apartments	Current
	Accrued Interest	n/a	1,022,757	n/a	n/a	-	-	Soft	Apartments	Current
	Big Bank Mortgage Payable	1993	771,051	4.25%	2023	41,093	33,722	Hard	Apartments	Current
	City of Green Redevelopment Agency	n/a	47,379	n/a	n/a	-	-	Soft	Apartments	Current
4	CalHFA	1987	71,961	3.00%	2018	3,387	2,420	Hard	Apartments	Current
	City of Green	1988	100,000	3.00%	2028	-	3,000	Soft	Apartments	Current
	Accrued interest	n/a	15,697	3.00%	n/a	-	-	Soft	Apartments	Current
	CalHFA	1988	579,820	6.00%	2028	16,577	35,129	Hard	Apartments	Current
5	USDA RD	2005	884,291	2-6%	2030	-	22,871	Hard	Apartments	Current
	City of Summers	2002	94,350	3.00%	2032	-	2,831	Soft	Apartments	Current
	CalHFA	2002	1,233,599	5.40%	2032	27,230	67,417	Hard	Apartments	Current
	CalHFA	2002	216,473	3.00%	2032	6,606	6,602	Hard	Apartments	Current
	Accrued Interest Payable	n/a	18,085	n/a	n/a	-	-	Soft	Apartments	Current
6	National Loan Servicing	1997	2,351,382	6.51%	2032	42,211	154,592	Hard	Apartments	Current
	Large City Housing Redevelopment Agency	1997	509,691	3.00%	2032	14,801	15,583	Hard	Apartments	Current
7	City of Green Housing Finance Agency	n/a	376,985	0.00%	n/a	-	-	Soft	Apartments	Current
	HCD	2006	836,227	3.00%	2063	-	-	Soft	Apartments	Current
	City of Green - Redev Agency	n/a	346,630	0.00%	n/a	-	-	Soft	Apartments	Current
	HCD HOME	2006	912,793	3.00%	2063	-	-	Soft	Apartments	Current
	AHP Loan	2006	45,000	0.00%	2063	-	-	Soft	Apartments	Current
8	Medium Bank Trust	1993	151,708	6.09%	2029	3,500	9,435	Hard	Apartments	Current
	City of Green Housing Trust Fund	1997	20,000	0.00%	2022	-	-	Soft	Apartments	Current
9	Big Bank	1996	321,270	4.25%	2023	8,652	8,915	Hard	Apartments	Current
	HCD	1991	1,066,686	3.00%	2052	-	-	Soft	Apartments	Current
	City of Green	1991	394,744	0.00%	2046	-	-	Soft	Apartments	Current
	City of Green - Bond Payable	1997	60,195	6.50%	2022	-	1,485	Hard	Apartments	Current

	Name of Creditor	Original Date	Current Balance	Interest Rate	Maturity Date	Annual Principal Payment	Annual Interest Payment	Hard or Soft Payments	Collateral	Current or Delinquent
10	HCD	1989	140,000	3.00%	2018	-	-	Soft	Apartments	Current
	Accrued Interest - HCD		86,267	n/a	n/a	-	4,200	Soft	Apartments	Current
	HUD FRRLP	1989	157,056	0.00%	Sale/Transfer	-	-	Soft	Apartments	Current
	CalHFA	1990	193,371	8.00%	2019	12,005	15,996	Hard	Apartments	Current
11	YCCC Sponsor Loan	2004	155,481	0.00%	2046	-	-	Soft	Apartments	Current
	HCD HOME	2001	520,453	3.00%	2033	-	-	Soft	Apartments	Current
	HUD Capital Advance	2000	1,267,700	0.00%	2045	-	-	Soft	Apartments	Current
	AHP Loan	2000	60,000	0.00%	2018	-	-	Soft	Apartments	Current
	HCD MHP Loan	2003	194,300	3.00%	2058	-	-	Soft	Apartments	Current
	Accrued Interest Payable	n/a	93,466	n/a	n/a	-	21,467	Soft	Apartments	Current
12	BHRA	2008	1,900,000	4.00%	2065	-	-	Soft	Senior Apartments	Current
	Medium Bank	n/a	1,324,000	5.27%	n/a	-	40,191	Hard	Senior Apartments	Current
13	City of Green CDBG	2000	430,899	0.00%	2060	-	-	Soft	Senior Apartments	Current
	City of Green Agency	2000	1,830,421	0.00%	2060	-	-	Soft	Senior Apartments	Current
	City of Green HOME	2000	1,212,736	0.00%	2060	-	-	Soft	Senior Apartments	Current
	First Regional	2004	869,485	7.09%	2034	12,269	63,000	Hard	Senior Apartments	Current
14	Medium Bank Trust	1994	456,958	456,958	2029	10,500	28,307	Hard	Senior Apartments	Current
15	City of Brown	2007	1,000,000	1.25%	2046	-	-	Soft	Mobile home pads	Current
	1st Trust RCAC	2009	1,000,000	1.00%	2029	45,420	9,768	Hard	Mobile home pads	Current
	RCAC - Verna	2009	958,535	0.00%	2029	-	-	Soft	Mobile home pads	Current
	Accrued Int - RCAC	n/a	10,000	n/a	n/a	-	10,000	Soft	Mobile home pads	Current
	CB&T- FHLB AHP	2009	1,000,000	0.00%	2063	-	-	Soft	Mobile home pads	Current
	HCD - MPROP	2009	2,100,000	3.00%	2038	-	-	Soft	Mobile home pads	Current
	Accrued Int - HCD	n/a	29,225	n/a	n/a	-	23,498	Soft	Mobile home pads	Current
	City of Brown	2007	117,594	5.04%	2020	-	5,933	Soft	Mobile home pads	Current
	City of Brown	2007	1,222,329	3.00%	2020	-	30,000	Soft	Mobile home pads	Current
	Total Original Amount	Total Current Balance	35,999,095		Total Monthly Payment	268,846	744,031			

Signature: ____ Title: ____ Date: _____________

Total Hard Debt (from above)	11,403,438	32%
Total Soft Debt (from above)	24,595,657	68%
Total Hard and Soft Debt	35,999,095	100%
Total Hard Debt Payments (from above)	802,586	79%
Total Soft Debt Payments (from above)	210,291	21%
Total Hard and Soft Debt Payments	1,012,877	100%

Hard Debt Maturity Dates

Year	Amount
2016	**See Note 1 to REO Schedule**
2018	71,961
2019	193,371
2021	86,912
2022	60,195
2023	1,092,321
2024	321,271
2028	579,820
2029	1,608,666
2030	884,291
2032	4,311,145
2034	869,485

NOTES TO NON PROFIT REO SCHEDULE

For

AFFORDABLE HOUSING OPPORTUNITIES CORPORATION
(Key Principal)

Note 1: The proposed FNMA refinancing of Property #6 provided $3,284,700 in new first mortgage loan proceeds while keeping in place an existing 35-year HOME Program rehab loan through the local redevelopment agency. The FNMA loan provided about $780,000 of discretionary-use cash-out to the Key Principal; plus payoff of the FHA 207 pursuant to 223(f) loan allowed the release of FHA property reserves of about $285,000. This resulted in a total unrestricted liquidity increase of $1,065,000 to the Key Principal. Proposed refinance loan term was 7 years maturing in 2016.

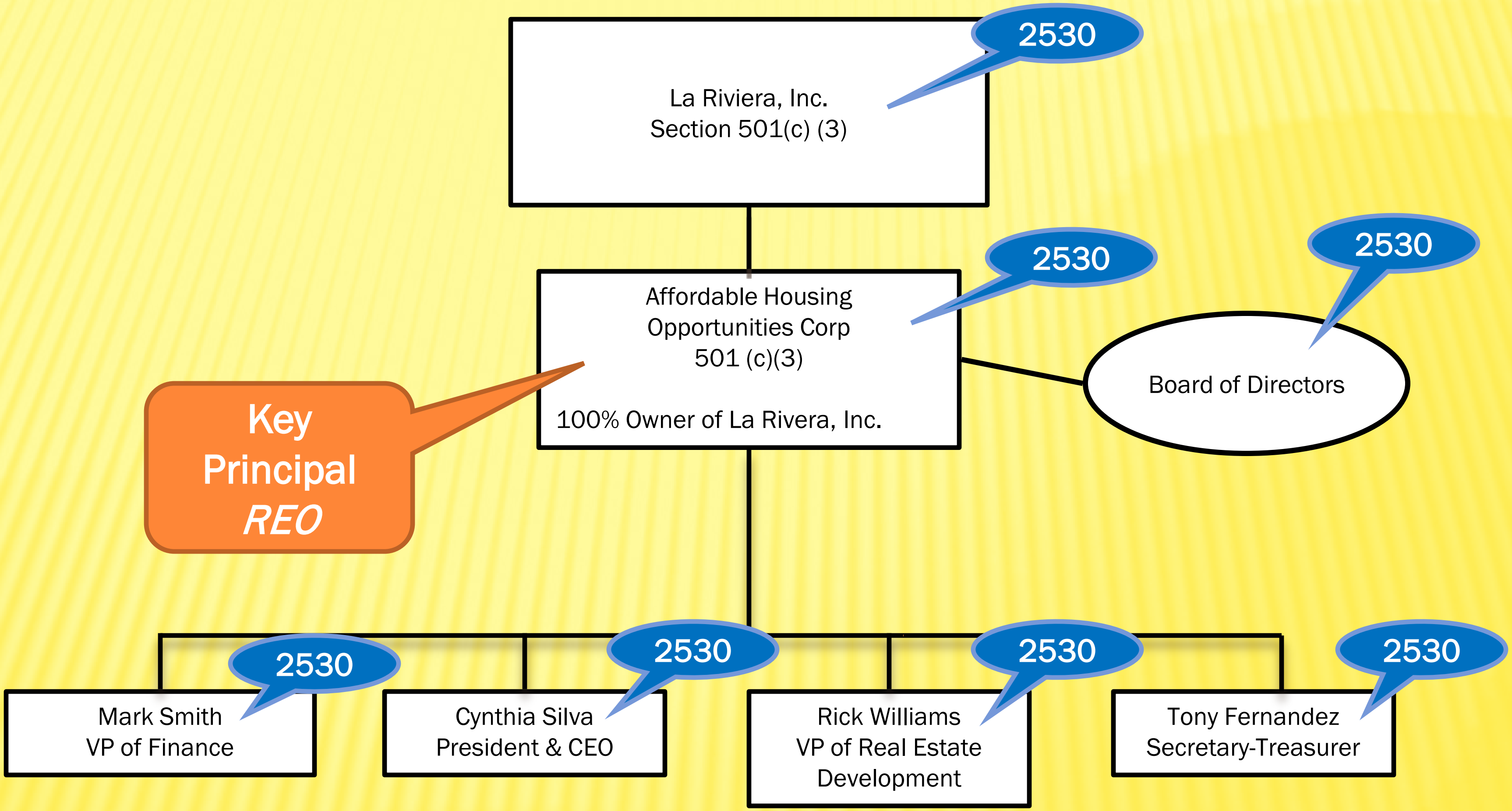
Note 2: LTV ratios shown in the REO Schedule are reflected based on Total Debt (hard and soft debt) and on Hard Debt only using the figures sourced from the Debt Detail Schedule. When the total Soft Debt is excluded, the portfolio LTV equates to only 59%; as compared to 187% inclusive of Soft Debt. Likewise, the portfolio DSCR on the required Hard Debt payments amounts to 1.74x.

Note 3: The negative current equity figures above reflect the heavy layering of Soft Debt on these properties. Soft Debt was built-up based on the cost to construct and/or renovate the properties and thus not necessarily linked to the property's actual Fair Market Value under its income and/or rent-restricted affordable use. As a corollary to LTV ratio excluding Soft Debt stated in Note 2, the portfolio Current Equity equates to $7,895,776 using the Hard Debt only, implying 41% equity based on Hard Debt only.

Note 4: Property #4, #8, #9 and #11 exhibit near break-even or negative cash flow after Hard Debt payments, warranting additional investigation. Management reported that the issue for these assets was rooted in a historical problem with the company's prior management administration. Rents at several of the properties were not being properly increased up to the allowable rent limits. This problem was addressed a couple of years ago coinciding with senior management personnel changes at the nonprofit. However, rents can only be increased gradually at reasonable increments in order to slowly re-establish maximum rent levels. Additional risk mitigants included the following: i) the combined annual operating deficit for these 4 properties amounted to only $12,834 per year, ii) the properties had operating deficit reserves that could be drawn upon with approval of the governing agency, and iii) the nonprofit had sufficient unrestricted discretionary-use cash to easily absorb these operating deficits until each property was re-stabilized.

Note 5: The figures initially reported by the Key Principal under the Present Market Value column above were based on their accounting book values, i.e. FMV of donated property on date of receipt, cost if purchased or constructed, and net of accumulated depreciation. Accordingly, the Lender restated these values by applying a blanket capitalization rate of 7.25% (due to their geographic concentration) to each property's reported NOI. However, using one cap rate for all the properties is an oversimplification and the Lender may be better served by differentiating between the properties based on their age, target market, and specific submarket locations.

Non Profit Borrower



Nonprofit Borrower Overview

- Ownership Structure Review
  - Single Asset Entity – IRC 501(c)(3) qualified
  - Wholly-owned by affordable housing developer – also a 501(c)(3)
  - Borrowing entity and parent corp. governed by BODs and appointed officers
  - No stock. Individual BODs and officers have no equity in ownership but provide real estate expertise and leadership to corporation to execute its charitable mission.
  - Parent corp. is sole entity “Key” Principal

- Mortgage Credit Review and REO Schedule focus is on Affordable Housing Opportunities Corporation (Parent Corp.)

General Observations – Nonprofit Developer

- Organization Structure
  - Most properties sponsored by nonprofits have considerable restrictions (i.e. ownership and property use) linked mainly to funding source but may also be tied to property tax abatement requirements, land use approvals, or other.
  - 501(c)3 qualified charitable organization is exempt from federal income tax and properties owned by a nonprofit may benefit from real estate tax abatements.
    - Example: California Welfare Exemption rules permit property tax exemption with nonprofit owner or general partner and units occupied by lower-income households (80% of AMI)

General Observations – Nonprofit Developer

- Organization Structure (continued)
  - Entity “Key” Principals vs. Individuals
    - Be an existing entity, not newly formed
    - Be a well-capitalized, stable, on-going business concern expected to continue to remain financially able to support the Property and all “Key” Principal requirements over the life of the mortgage loan
    - Typically the entity assets and net worth would be significantly in excess of what would be minimally acceptable for an Individual “Key” Principal
    - Be a type of business that would make it unlikely that assets would be siphoned off for use by other entities.
      - i.e. Not a multi-asset entity with commingled funds

Brief Background on Case Study Nonprofit Developer

- Nonprofit Mission: Increase supply of affordable housing for very low, low, and moderate income households
- 4 Basic Programs:
  - Affordable housing development (MF and SF)
  - Property management
  - Resident services
  - Advocacy – educating decision makers and community members on housing needs of nonprofit's constituents
- History
  - Began in 1984 as small community development organization
  - Successful track record with broad range of local, state and federal housing finance programs
  - Relatively new CEO and senior management team but stable Board of Directors with strong credentials and ties to the local community

Nonprofit REO Schedule – General Observations

- Portfolio of 14 stabilized Multifamily properties containing 442 units (11 Family projects and 3 Senior Apartment properties), plus 1 Mobile Home Park with 155 pads that just completed construction
- Apparent geographic concentration of assets within Green, Greensville, Big City – all within about 45 miles. Good from a property management perspective; but could be a weakness if market area has an identified inherent risk.
- 100% Ownership in all assets. Full control, self-managed
- Property ages predominantly from early 1990s and later

Nonprofit REO Schedule – General Observations

- High occupancy levels at every property indicating stabilization with no properties under construction or in initial lease-up.
  - Properties are all self-managed by a wholly-owned subsidiary of the Key Principal nonprofit entity.
  - High occupancies suggest sound management practices and speak well of the nonprofit’s internal property management organization.
- Very high LTVs, negative Current Equity, mix of high and low DSCRs suggesting additional investigation/explanations needed.

Nonprofit REO Schedule – Specific Categories

Existing Debt / Type of Mortgage

- Typical to see numerous loans (1st, 2nd, 3rd mortgages) from various government agencies. Loans may reflect a variety of structures and payment terms.
- **Hard Debt** - requiring mandatory payments of principal and interest.
- **Soft Debt** - payments made only from residual cash flow; may be interest-only; may accrue interest to be paid out of future net cash flow and residuals or at maturity; may be forgivable at maturity.
- Debt may reflect favorable terms through low interest rates, interest-only payments, no interest, or deferred payments.

Nonprofit REO Schedule – Specific Categories

Existing Debt / Type of Mortgage (continued)

- Soft Debt and favorable payment structures are generally in exchange for long-term affordability requirements and resale restrictions on the property.
- Federal, state and local agency funding sources have goals to create affordable housing and these debt sources will generally provide favorable terms so long as borrower maintains compliance with the affordability and other requirements.
- At maturity loans may be restructured, forgiven, or renegotiated based on the property’s capital needs at that time.
- May be a grant with no repayment required.
- Debt Detail Schedule details the Hard and Soft debt for the Key Principal entity. About 68% of the total portfolio debt is Soft Debt.

Nonprofit REO Schedule – Specific Categories

Annual Operating Expenses

- Verify that reported expenses are fully loaded to include property management fees, reserves for replacements, taxes, insurance, etc.
  - Real estate tax exemptions may be applicable to properties

Market Values

- Values recast by Lender at 7.25% cap rate because Nonprofit initially reported accounting book values in lieu of FMV.
- Used one cap rate for all properties due to same general locale, but may need to differentiate based on age, target market, specific location, etc.

Nonprofit REO Schedule – Specific Categories

LTV Ratios

- Driven up due to layering of Soft Debt on the properties.
- Combination of high overall debt plus rent restrictions on properties (reducing NOI) results in very high LTVs.
- Affordable properties with real estate tax abatements can still result in reduced NOIs due to a combination of low rents and higher management, administration and possibly maintenance expenses for the project.

Nonprofit REO Schedule – Specific Categories

LTV Ratios (continued)

- Look at LTV ratios based on Hard Debt payments only
- Using the Lender imputed values (7.25% cap) the portfolio Hard Debt LTV (excluding all Soft Debt) is about 60%.

Nonprofit REO Schedule – Specific Categories

Current Equity

- Negative equity amounts driven by high levels of debt to fund initial property acquisition/development or renovation
- Debt based on overall development cost of project. And cost may well exceed the FMV of the property with the affordability requirements.
- Property income is restricted. Also, expenses may run higher for property management, administration, and capital expenses
- Nonprofits generally do not build-up significant equity or cash surpluses for any period of time. Surpluses are redeployed toward new projects to meet the charitable mission of the entity

Nonprofit REO Schedule – Specific Categories

Annual Debt Service and Debt Service Coverage Ratio

- Need detailed Debt Schedule to understand Hard Debt and Soft Debt payment structures
- Required Hard Debt payments used to calculate Hard Payment DSCRs
- Hard Payment DSCRs provide measure of the project's ability to meet its required debt obligations. Soft Payments are not mandatory and Soft Debt may not ever need to be repaid

Nonprofit REO Schedule – Specific Categories

Annual Debt Service and DSCR (continued)

- Property #4, #8, #9 and #11 show near break-even or negative cash flow after Hard Debt payments, warrants additional investigation
  - Management reported cash flow issues due to prior administration not properly implementing rent increases at the properties
  - Problem addressed with change in senior management personnel. Rent increases being implemented
  - Combined annual operating deficit for the 4 properties amounts to only $12,834.
  - Properties have operating deficit reserves that can be drawn with approval from the governing agency.

Risks of a Nonprofit

- Funding sources and related regulatory and loan agreements restrict property activities; continuing program compliance reporting; subject to audits
- State budget crises - elimination and/or reduction of previously available funding sources due to defunding of community redevelopment programs, etc. Not an easy time for nonprofits.
- General lack of unrestricted, discretionary cash available to service property shortfalls
  - Most cash accounts tied to individual projects due to SAE ownerships and agency funding requirements

Risks of a Nonprofit

- Developer fees a primary revenue source. Opportunities have temporarily dried up. Diminishing project pipeline
- Overly mission-driven nonprofit staff without proper emphasis and resources devoted to maximizing project income and meeting financial obligations, e.g. not increasing rents when it should
- Could be a relatively newly formed nonprofit with a limited business history; limited staff; limited real estate expertise in terms of development, property management, asset management; and limited ties to the local business community.
- Lack of continuity or tenure of senior management or BOD

Risk Mitigants for a Nonprofit

- Nonprofit may have equity in projects without agency funding restrictions that can provide cash through refinancing – that was the case for Property #6 in this case study.
- Advantageous Soft Debt loan terms
- Existing pipeline of development projects to carry the business through the next couple of years permitting time to develop new revenue sources.
- Revenue diversification, multiple sources of ongoing revenues, e.g. energy-related single family home retrofitting for low-income households - program sponsored by local utility companies.
- Designated CHDO (Community Housing Development Organization) giving company priority to agency funding sources over for-profit entities.
- Availability of unsecured lines of credit

Risk Mitigants for a Nonprofit

- Increase Grant writing to access funds based on resident services programs of nonprofit
- Extensive track record and nonprofit business history with continuity in the BOD with strong ties to the local community in which they operate
- REO Schedule properties that may have project-based Section 8 contracts
- Importance of professional credentials, experience and background of corporate officers and senior management.
  - Case Study Nonprofit recruited management personnel with significant for-profit experience at the corporate level

Case Study Nonprofit Conclusions

- Nonprofit has limited accumulated net assets and generally limited unrestricted liquidity per charitable mission; however:
  - Verified unrestricted, discretionary use cash of $2 million available post-closing plus $1 million unsecured line of credit
  - Liquidity deemed adequate based on $3.3 million proposed loan and considering the strengths of the real estate underwriting
  - Historical review of total net assets and unrestricted portion of net assets over prior 6 years revealed stable to slightly increasing figures.
  - Evaluation of entity Key Principal nonprofit activities and ongoing business model deemed acceptable. Development of diversified revenue sources, REO Schedule acceptable
- Length of nonprofit's business history important
  - Measure of stability and ability to withstand economic cycles
- Case Study Nonprofit CEO recruited management personnel with significant for-profit experience to overcome prior administration weaknesses.

Case Study Nonprofit Conclusions

- Case Study Nonprofit had a long business history (25+ years) indicating a stable going concern and an acceptable development and property management track record.
- Underperforming assets on REO Schedule being addressed
  - Small aggregate annual deficit of only $12,834
  - Operating deficit reserves available, rents being increased
  - New property management in place
  - Remaining properties have adequate DSCRs on hard debt
- Subject real estate underwritten to a 1.35x DSCR (including full real estate taxes, without consideration of the ongoing abatement)
- Key Principal deemed credit worthy and an effective developer, owner, and manager.

Attachment A

SCHEDULE OF OTHER REAL ESTATE HOLDINGS

Borrower's Name (Borrower Principal Name) & the proposed project name: ____________________

Borrower/Borrower's Principal Name #1 (Owner(s) of property (include all legal and beneficial owners of property)) One schedule for each Principal

Property Name & Address	Recourse/ Contingency Liabilities	Type of Property and # of Units	Ownership Role	Ownership Percentage %	Current Physical Occupancy %	Annual Net Income (NOI)	Maturity Date	Present Market Value	Existing Amount of Mortgages, Liens	Current Equity (% x Market Value - Existing Indebtedness)	Annual Debt Service	Interest Rate	Type of Rate (Fixed, fixed bonds, variable, etc.)	If variable, date last reset.	Debt Service Coverage Ratio	Is Loan Current or Delinquent? Maturity Default?	Pending Judgments, Legal Suits/Actions or Bankruptcy Claims
1 Project 1	$168,500	Land	GP	0.425%	N/A	$ -	Oct-10	$ 8,000,000	$ 1,685,500	$ 26,837	$ 101,130	6.00%	Fixed/ Balloon/IO		N/A	Current	None
Project 2		Office/Retail/47 units	GP	1.60%	89.00%	$ 2,646,910	Jul-11	$ 32,650,000	$ 19,391,739	$ 212,132	$ 1,172,780	5.90%	Fixed/ Balloon		2.26	Current	None
Project 3		Retail/7-11 & Walgreens	GP	55.87%		$ 543,326	Jun-16	$ 12,000,000	$ 7,500,000	$ 2,514,240	$ 491,250	6.65%	Fixed/ Balloon/IO		1.11	Current	None
Project 4		Multifamily/200 units	Managing Member	0.875%		$ 1,170,291	Apr-10	$ 19,500,000	$ 13,130,000	$ 55,738	$ 772,117	5.80%	Fixed/ Balloon		1.52	Maturity Default	None
Subject Property		Multifamily/228 units	Managing Member	0.875%		$ 1,539,060	Apr-10	$ 23,000,000	$ 15,310,000	$ 67,288	$ 1,208,928	5.80%	Fixed/ Balloon		1.27	Maturity Default	None
Project 6		Neighborhood Shopping	GP	2.39%		$ 2,287,900	Nov-11	$ 42,750,000	$ 22,263,733	$ 489,622	$ 1,438,883	5.75%	Fixed/ Balloon		1.59	Current	None
Project 7	$2,117,577	Multifamily/208 units	GP	3.43%		$ 1,478,206	Sep-10	$ 26,500,000	$ 21,175,773	$ 182,621	$ 1,538,197	6.50%	Fixed/ Balloon		0.96	Current	None
Project 8		Condos/73 units (part of condo - held as rental)	GP	10.07%		$ 306,607	Oct-10	$ 7,700,000	$ 3,893,055	$ 383,169	$ 258,543	6.00%	Fixed/ Balloon		1.19	Current	None
Project 9		Land	GP	2.87%		$ -	N/A	$ 7,750,000	$ -	$ 222,348	$ -						None
Project 10		Office	GP	4.63%	92.00%	$ 1,480,572	Jan-11	$ 25,000,000	$ 10,217,472	$ 684,431	$ 306,524	3.00%	Floating/ Balloon/IO	3/1/2010	4.83	Current	None
Project 11*		Neighborhood Shopping	GP	6.70%	37.00%	$ 1,681,407	Nov-11	$ 45,000,000	$ 37,112,962	$ 528,432	$ 2,396,818	6.13%	Fixed/ Balloon		0.70	Current	None
Project 12		Office	Managing Member	22.69%	89.00%	$ 449,629	Dec-25	$ 4,200,000	$ 2,962,420	$ 280,807	$ 315,453	6.75%	Fully Amortizing		1.43	Current	None
Project 13		Flex Land	Managing Member	22.69%		$ -	N/A	$ 4,400,000	$ -	$ 998,360	$ -						None
Project 14		Land	Managing Member	50.00%		$ -	N/A	$ 2,700,000	$ -	$ 1,350,000	$ -						None
Project 15	$394,783	Commercial/ Industrial	Managing Member	32.67%		$ 188,262	Nov-09	$ 3,500,000	$ 3,947,825	$ (146,304)	$ 388,000	8.41%	Fixed/ Balloon		0.49	Maturity Default	None
Project 16		Multifamily/5690 Units - Improving Market	Limited Partner	1.49%	88.00%	$ 26,281,693	Feb-16	$ 375,452,000	$ 398,742,156	$ (346,790)	$ 25,665,000	6.06%	Fixed/ Balloon		1.02	Current	None
Project 17		Office/Industrial/ Condo/Retail	GP	5.59%		$ 6,759,000	Dec-15	$ 66,534,024	$ 30,038,400	$ 2,039,740	$ 2,691,000	5.50%	Fixed/ Balloon		2.61	Current	None
Project 18		Power Retail/Condo/ Land	Limited Partner	1.48%		$ 7,849,000	Dec-15	$ 118,673,333	$ 81,021,000	$ 555,372	$ 5,943,597	7.00%	Fixed/ Balloon		1.32	Current	None
Project 19		Office/Land/ Multifamily/Retail	Managing Member	50.00%		$ -	Dec-16	$ 4,700,000	$ -	$ 2,350,000	$ -						None
						$ -				$ -							
TOTALS/AVERAGES	$2,680,860					$54,661,863		$830,009,357	$668,392,035	$12,448,040	$44,688,220	6.08%			1.22		

INFORMATION PRESENTED IS AS OF June 30, 2010.
NOI represents six months annualized

*PLEASE INCLUDE ALL PROPERTIES IN WHICH YOU HAVE 25% OR MORE OWNERSHIP INTEREST OR ANY PROPERTIES IN WHICH YOU HAVE GENERAL PARTNER, KEY PRINCIPAL OR MANAGING MEMBER INVOLVEMENT.

I hereby certify that the above list (and/or attached lists, if necessary) are complete and correct and are a true listing of my past and present real estate owned to the best of my knowledge and belief, and are made or provided in good faith.

Warning: HUD will prosecute false claims and statements. Conviction may result in criminal and/or civil penalties. (U.S.C. 1001, 1010, 1012; 31 U.S.C. 3729, 3802)

By: ____________________
Title: ____________________

LENDER ANALYSIS

	Lender Imputed Debt Constant	Debt Svc Imputed	Imputed DSCR	Imputed Cap on Borrower Value	Lender Cap	Value at Lender Cap	Current LTV at Lender Cap	Lender's Est. Imputed Equity	Cashflow After Mtge	Principal Share of Cashflow
Project 1	7.50%	$126,413				8,000,000	21%	26,837	(101,130)	(430)
Project 2	7.37%	$1,428,987	1.85	8.11%	8.50%	31,140,118	62%	187,974	1,474,130	23,586
Project 3	7.37%	$552,679	0.98	4.53%	8.00%	6,791,575	110%	(395,811)	52,076	29,096
Project 4	6.08%	$798,333	1.47	6.00%	7.00%	16,718,443	79%	31,399	398,174	3,484
Subject Property	6.08%	$930,882	1.65	6.69%	7.00%	21,986,571	70%	58,420	330,132	2,889
Project 6	7.37%	$1,640,626	1.39	5.35%	8.50%	26,916,471	83%	111,200	849,017	20,292
Project 7	6.08%	$1,287,534	1.15	5.58%	6.50%	22,741,631	93%	53,709	(59,991)	(2,058)
Project 8	6.08%	$236,706	1.30	3.98%	5.50%	5,574,673	70%	169,255	48,064	4,838
Project 9	7.50%	$0				7,750,000	0%	222,348	-	-
Project 10	7.37%	$752,931	1.97	5.92%	8.50%	17,418,494	59%	333,407	1,174,048	54,358
Project 11*	7.37%	$2,734,873	0.61	3.74%	8.50%	41,545,965	89%	297,011	1,134,589	76,017
Project 12	7.37%	$218,302	2.06	10.71%	8.50%	5,289,753	56%	528,072	134,176	30,445
Project 13	7.50%					4,400,000	0%	998,360	-	-
Project 14	7.50%					2,700,000	0%	1,350,000	-	-
Project 15	7.37%	$290,917	0.65	5.38%	9.00%	2,091,800	189%	(606,363)	(199,738)	(65,254)
Project 16	6.08%	$24,244,415	1.08	7.00%	7.00%	375,452,757	106%	(346,779)	616,693	9,183
Project 17	7.37%	$2,213,545	3.05	10.16%	9.00%	75,100,000	40%	2,518,493	4,068,000	227,361
Project 18	7.37%	$5,970,478	1.31	6.61%	8.00%	98,112,500	83%	252,100	1,905,403	28,105
Project 19	7.37%	$0				4,700,000	0%	2,350,000	-	-
Totals/Avg		**$43,427,621**				**774,430,750**	**86%**	**8,139,630**	**11,823,643**	**441,910**

LENDER ASSUMPTION	Constant	Rate	Term
Rate - Residential	6.08%	4.50%	30 years
Rate - Commercial	7.37%	5.50%	25 years
Rate - Land	7.50%	7.50%	IO years

* Project #11 Analysis assumes added $1,850,000 income from new tenant (see narrative).

PRINCIPAL #2
LENDER BACKUP TO REO SCHEDULE

PROJECT #1: This is vacant land, with the borrower intention to hold for future development. The lender is in receipt of a letter from the current lender indicating that it is anticipated that the loan will be renewed. Principal #2 has a 10% contingent liability on this loan for $168,500.

PROJECT #2: While the loan has a mortgage that balloons in 2011, the current project economics would appear to indicate that the borrower will be able to refinance at that time.

PROJECT #3: Mortgage balloons more than five years out, and, while debt coverage is minimum at 1.10x, project is currently cashflowing. No additional information appears warranted.

PROJECT #4: We have filed a simultaneous application for 223(f) mortgage insurance that is sufficient to take out the existing debt on this project. Lender's Imputed Cap and Value are as found in that application. Assuming HUD's approval of that loan, the mortgage will be repaid in full. The existing CMBS loan is in a maturity default. XYZ, the master servicer for the loan, has been unwilling to provide a formal written extension of the maturity, although, per the attached email, they have provided an outline of extension fees that will be due so long as the loan is repaid by December 31, 2010.

SUBJECT PROPERTY: Similar to Project #4, this loan is in maturity default but is anticipated to be repaid in full through the proceeds of the subject loan.

PROJECT #6: Existing debt that balloons in November of 2011 is likely able to be refinanced based upon project economics. Note that Borrower's LTV at 53% would require a cap rate based upon current NOI would be 5.35%. Imposing an 8.5% cap rate on the same NOI results in a current LTV in the range of 83%, with an imputed debt service coverage assuming current rates at 1.39x.

PROJECT #7: LTV and DSC are marginal on this loan, which matures in September of 2010. The loan documents provide for an additional one year extension, which is in the process of being exercised. Principal #2 has a $2.1MM contingent liability on this loan.

PROJECT #8: Same as Project #1, although the loan is nonrecourse with no contingent liability carried against the financial statement. Again, the principal is holding the land for sale or future development. It is anticipated that the current loan will be extended in the normal course of business.

PROJECT #9: Vacant land/no debt.

PROJECT #10: The property is a performing asset with a loan that matures in January of 2011. The Borrower is currently negotiating an extension of the existing loan with the bank. The current debt is floating rate/interest only with a current rate of 3.0%. The borrower has a cap at approximately 6.0%. Lender has stress tested the loan assuming fixed rate, 10-year financing to determine whether or not it will be refinanceable at the time of the balloon, and has determined that, given the imputed DCS and LTV ratios, should the current lender elect not to extend, the project should be refinanceable.

PROJECT #11: While the project is currently experiencing negative cashflow, this is a short-term situation. A major anchor tenant vacated the project in late 2009. The Borrower is in the process of completing tenant improvements that will result in a new tenant occupying the space by early 2011, with expected additional net operating income of $1,850,000. The resulting NOI will provide sufficient income to cover debt service on the existing loan. The Borrower has posted an operating reserve to cover the debt service shortfall for the intervening period, and the loan remains current. Based upon the projected cashflow after the new tenant is in place, the project is expected to have a DSC of 1.47x based upon the current loan amount. Using our imputed value, the LTV and

DSC would be 89% and 1.29x respectively. Current debt matures in November of 2011, and is expected to either be extended or refinanced at that time.

PROJECT #12: Fully amortizing debt with reasonable DSC. Additional information not required.

PROJECT #13: Vacant land/no debt

PROJECT #14: Vacant land/no debt

PROJECT #15: This project, which has a maturity default from 2009, has been assigned to a Special Servicer. Over the past four years, the market (Detroit area) has taken a significant downturn and several tenants have defaulted. The Borrower has been unable to obtain a new mortgage or receive an extension from the Securitized Mortgage Lender. Absent an extension, there will likely be a foreclosure on this property. Although the loan is non-recourse, the three Managers (including Principal #1) have contributed over $750,000, or 19% of the current mortgage amount, over the past 10 years to maintain the property and keep the loan current. One third of the contributions have come from Principal #2. No distributions have been taken since 2006. We believe the good faith efforts of Principal #2 provide evidence of his character and that issues surrounding this asset should not preclude his participation in the HUD mortgage insurance programs.

PROJECT #16: This project is currently at a 1.02 DSC (based upon a 6.06% interest rate). At a 4.50%/30 year amortization, the DSC would be 1.08x, which would still be difficult to refinance, especially given the fact that the project is current over-leveraged. The loan does not balloon for over five years, and the property is located in an improving market. Given the fact that the principal's ownership interest is only 1.49%, and is limited and nonrecourse in nature (he was a minor investor in the property, and likely did not even need to include it on this REO schedule), we would not expect the property to impact his ability to handle issues that arrive on the subject property.

PROJECT #17: Maturity more than five years out. Very low LTV and significant cashflow.

PROJECT #18: Maturity more than five years out. Project is cash-flowing at 1.32x. No further analysis required.

PROJECT #19: No existing debt

PRINCIPAL ANALYSIS:

The principal's financial statement indicates equity in real estate owned of $12,900,000. The REO schedule would indicate equity of $12,448,040. The differential is not significant enough to warrant concern.

Borrower's indicated net worth on the financial statement is approximately $33,000,000, including $12,900,000 of equity in real estate, $6,300,000 in cash and marketable securities, and $8,000,000 in non-marketable securities.

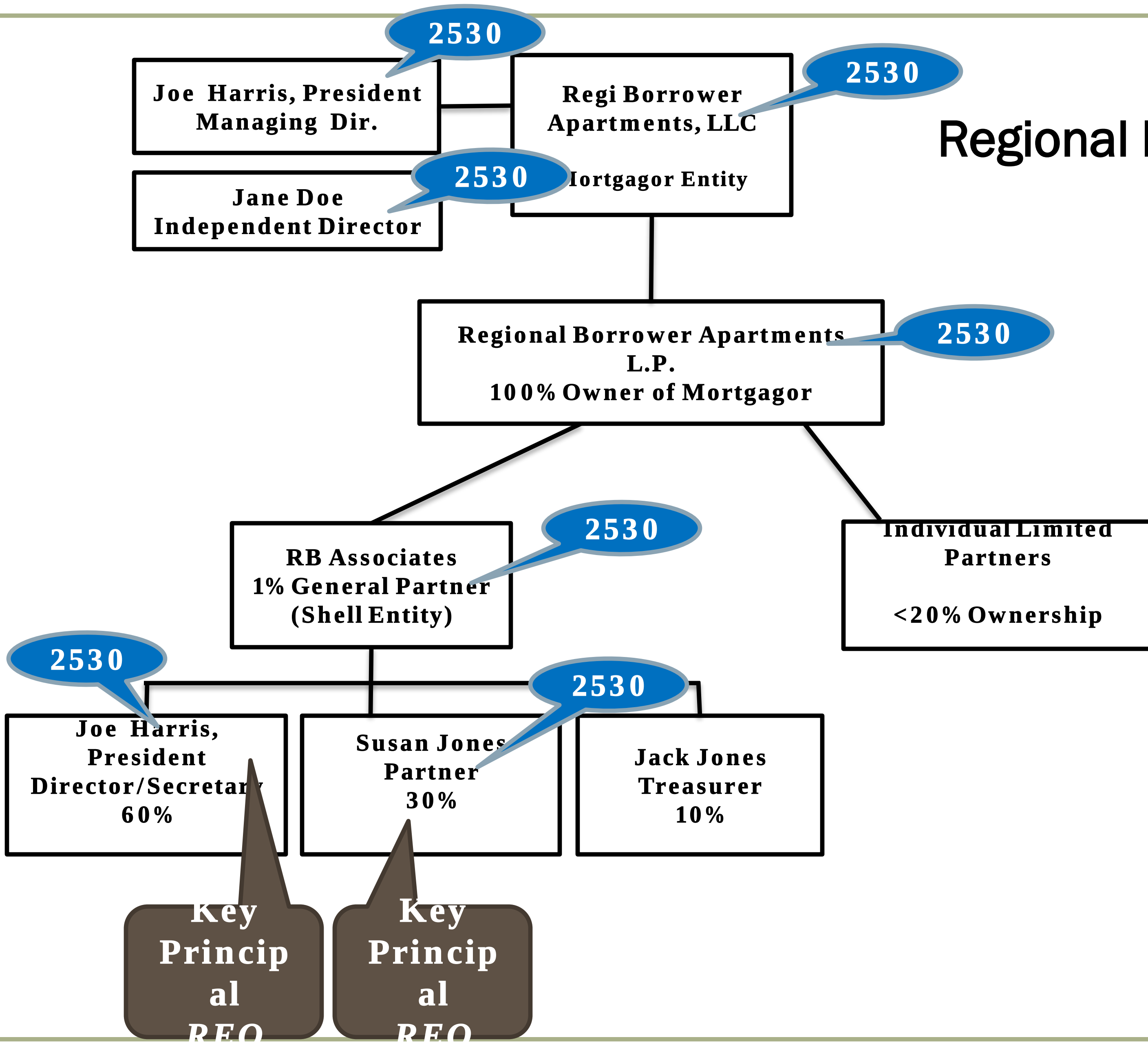
The REO Schedule of Principal #2 indicates a couple of projects with some issues, but an overall annual positive cashflow of $441,910 to the principal. Contingent liabilities of $2,117,577 and $394,783 may come into play on Projects #7 and #15 over the next few years.

Given the strength of the principal's financial statements, we believe him to be an acceptable risk. We would point out that the lender's analysis conservatively reduces the principal's imputed equity in real estate to $8,140,000, which does not change our conclusions as to the Principal's strength.

Principal #2
Lender Analysis of REO Schedule
Regional Borrower

Cathy Pharis

Regional Borrower v2



Project #1:

This is vacant land, with the borrower intention to hold for future development. The lender is in receipt of a letter from the current lender indicating that it is anticipated that the loan will be renewed. Principal #2 has a 10% contingent liability on this loan for $168,500.

Project #2:

While the loan has a mortgage that balloons in 2011, the current project economics would appear to indicate that the borrower will be able to refinance at that time.

Project #3:

Mortgage balloons more than five years out, and, while debt coverage is minimum at 1.10x, project is currently cash-flowing. No additional information appears warranted.

Project #4:

We have filed a simultaneous application for 223(f) mortgage insurance that is sufficient to take out the existing debt on this project. Lender's Imputed Cap and Value are as found in that application. Assuming HUD's approval of that loan, the mortgage will be repaid in full. The existing CMBS loan is in a maturity default. XYZ, the master servicer for the loan, has been unwilling to provide a formal written extension of the maturity, although, per the attached email, they have provided an outline of extension fees that will be due so long as the loan is repaid by December 31, 2010

Similar to Project #4, this loan is in maturity default but is anticipated to be repaid in full through the proceeds of the subject loan.

Project #6:

Existing debt that balloons in November of 2011 is likely able to be refinanced based upon project economics. Note that Borrower's LTV at 53% would require a cap rate based upon current NOI would be 5.35%. Imposing an 8.5% cap rate on the same NOI results in a current LTV in the range of 83%, with an imputed debt service coverage assuming current rates at 1.39x.

Project #7:

LTV and DSC are marginal on this loan, which matures in September of 2010. The loan documents provide for an additional one year extension, which is in the process of being exercised. Principal #2 has a $2.1MM contingent liability on this loan.

Project #8:

Same as Project #1, although the loan is nonrecourse with no contingent liability carried against the financial statement. Again, the principal is holding the land for sale or future development. It is anticipated that the current loan will be extended in the normal course of business.

Project #9:

Vacant land/no debt.

The property is a performing asset with a loan that matures in January of 2011. The Borrower is currently negotiating an extension of the existing loan with the bank. The current debt is floating rate/interest only with a current rate of 3.0%. The borrower has a cap at approximately 6.0%. Lender has stress tested the loan assuming fixed rate, 10-year financing to determine whether or not it will be refinanceable at the time of the balloon, and has determined that, given the imputed DCS and LTV ratios, should the current lender elect not to extend, the project should be refinanceable.

Project #11:

While the project is currently experiencing negative cashflow, this is a short-term situation. A major anchor tenant vacated the project in late 2009. The Borrower is in the process of completing tenant improvements that will result in a new tenant occupying the space by early 2011, with expected additional net operating income of $1,850,000. The resulting NOI will provide sufficient income to cover debt service on the existing loan. The Borrower has posted an operating reserve to cover the debt service shortfall for the intervening period, and the loan remains current. Based upon the projected cashflow after the new tenant is in place, the project is expected to have a DSC of 1.47x based upon the current loan amount. Using our imputed value, the LTV and DSC would be 89% and 1.29x respectively. Current debt matures in November of 2011, and is expected to either be extended or refinanced at that time.

PROJECT #12: Fully amortizing debt with reasonable DSC. Additional information not required.

PROJECT #13: Vacant land/no debt

PROJECT #14: Vacant land/no debt

Project #15:

This project, which has a maturity default from 2009, has been assigned to a Special Servicer. Over the past four years, the market (Detroit area) has taken a significant downturn and several tenants have defaulted. The Borrower has been unable to obtain a new mortgage or receive an extension from the Securitized Mortgage Lender. Absent an extension, there will likely be a foreclosure on this property. Although the loan is non-recourse, the three Managers (including Principal #1) have contributed over $750,000, or 19% of the current mortgage amount, over the past 10 years to maintain the property and keep the loan current. One third of the contributions have come from Principal #2. No distributions have been taken since 2006. We believe the good faith efforts of Principal #2 provide evidence of his character and that issues surrounding this asset should not preclude his participation in the HUD mortgage insurance programs.

Project #16:

This project is currently at a 1.02 DSC (based upon a 6.06% interest rate). At a 4.50%/30 year amortization, the DSC would be 1.08x, which would still be difficult to refinance, especially given the fact that the project is current over-leveraged. The loan does not balloon for over five years, and the property is located in an improving market. Given the fact that the principal's ownership interest is only 1.49%, and is limited and nonrecourse in nature (he was a minor investor in the property, and likely did not even need to include it on this REO schedule), we would not expect the property to impact his ability to handle issues that arrive on the subject property.

PROJECT #17: Maturity more than five years out. Very low LTV and significant cashflow.

PROJECT #18: Maturity more than five years out. Project is cash-flowing at 1.32x. No further analysis required.

PROJECT #19: No existing debt

The principal's financial statement indicates equity in real estate owned of $12,900,000. The REO schedule would indicate equity of $12,448,040. The differential is not significant enough to warrant concern.

Borrower's indicated net worth on the financial statement is approximately $33,000,000, including $12,900,000 of equity in real estate, $6,300,000 in cash and marketable securities, and $8,000,000 in non-marketable securities.

The REO Schedule of Principal #2 indicates a couple of projects with some issues, but an overall annual positive cashflow of $441,910 to the principal. Contingent liabilities of $2,117,577 and $394,783 may come into play on Projects #7 and #15 over the next few years.

Given the strength of the principal's financial statements, we believe him to be an acceptable risk. We would point out that the lender's analysis conservatively reduces the principal's imputed equity in real estate to $8,140,000, which does not change our conclusions as to the Principal's strength.

Case Studies

- Yes
- No
- Maybe – what mitigants / conditions?

Case 1

- Well capitalized sponsor – 80% 223(f) loan with no cash out
- Family business – 2 brothers – own/manage a total of 25 properties
- Their portfolio includes 10 FHA insured properties they own/manage in the region – never any mgt findings or concerns
- A trust for estate planning purposes
- Both principals have FICO scores in the high 700 range, no defaults, judgments, etc.

Case 2

- Borrower has 3 insured HUD loans, all in good standing. Up until 5 years ago, this was a “good borrower, good credit”
- Bankruptcy 2 years ago, key principal was sick for a year, and the business wasn’t managed well. The principal recovered and is getting the business back on track. The refinancing of the current high interest rate loan will solve the problems.
- 3 Judgments – 1 from a slip and fall lawsuit, 1 from delinquent trade payables, 1 from IRS liens for unpaid payroll taxes.
- On a payment plan for delinquent RE Taxes.
- FICO score of 425. Negative liquidity, Breakeven net worth.
- Mitigants: The refinancing will solve the cash flow problem. Cash out will clear all of the delinquencies. Land is very valuable (resort community) and vacant is worth as much as the loan.

Case 3

- New Construction deal in a market near major military base. 36 months of process, ready to submit Firm.
- Sponsor = the decision maker – 50%, the money – 40%, and GC – 10%.
- 30 days prior to submission of the firm, the decision maker’s credit (early 2009) falls off a cliff – defaults / foreclosures, FICO score plummets

Case 4

- Experienced, small scope Borrower, owns/manages 4 properties, good liquidity/net worth, no credit or financial capacity concerns in last 20 years.
- Discloses he is a convicted Felon, mortgage fraud – 25 years ago he pled guilty and went to jail (served 18 months of a 4 year sentence) for mis-representation in single family loan origination / brokerage business.

Case 5

- Strong financials, 80% LTV 223(f) with no cash out. Borrower has one key principal who owns 90% of the subject property, 3 limiteds own the other 10%.
- Borrower owns 2 other properties with moderate leverage and no balloons coming due. He is a foreign national, 20 years of US residency, in good standing with Immigration authorities (and has a recent letter from them documenting that status).
- Key principal has clean credit. Didn't disclose he is a convicted Felon (came out in the OFAC check). Explained didn't understand this info was relevant or requested, provided letter and explanation.
- Explanation: Got out of prison 9 years ago, served 12 months for money laundering – a distant relative had money to invest and our principal was a Real Estate broker and arranged purchase of a small rental property. It turns out the relative's money was proceeds from criminal activity and he got caught.
- Second conviction of a misdemeanor 2 years ago. States it was an entrapment situation and he was just kidding.

U.S. Department of Housing and Urban Development

Special Attention of All Multifamily Hub Directors All Program Center Directors All Project Managers All Field Office Directors	Notice H 2010-11 Issued: July 6, 2010 Expires: July 31, 2011
	Cross References Mortgagee Letter 2010-21

SUBJECT:
HUD Multifamily Risk Mitigation

I. Purpose

This Housing Notice revises underwriting standards, policies and procedures for mortgage insurance under the Federal Housing Administration's (FHA's) Multifamily Housing programs. This Housing Notice is not applicable to the health care programs administered by the Office of Healthcare Programs (Section 232, or refinancing of Section 232 pursuant to Sections 223 (f) or 223 (a) (7)). The Notice will be effective 60 days from the date of issuance, as discussed below in the section titled "Implementation".

The core program underwriting standards have not been adjusted since the inception of the program and it is appropriate to do so at this time. These changes are in response to changes in real estate and financing markets and are intended to mitigate the Department's risk while ensuring the continued availability of FHA insurance.

II. Background

On January 6, 2010, the Federal Financial Institutions Examination Council (FFIEC) issued an Advisory to remind institutions of supervisory expectations regarding sound practices for managing risk. The FFIEC noted the challenging financial environment and stated,

> "Current financial market and economic conditions present significant risk management challenges to institutions of all sizes. For a number of institutions, increased loan losses and sharp declines in the values of some securities portfolios are placing downward pressure on capital and earnings."

This cautionary note is consistent with increases in vacancy and delinquency rates and increases in defaults and claims in FHA's portfolio. Interest in FHA insurance has dramatically increased as other sources of commercial financing have not been available. FHA is committed to playing a critical role in restoring health to the multifamily housing market by assisting qualified Borrowers to access mortgage financing when private capital is scarce. With this increased role comes increased risk and responsibility for the integrity of the FHA mortgage insurance fund.

Separately, HUD is also revising Lender capitalization, licensing and monitoring requirements, updating legal documents, and modernizing HUD's information systems and business processes. This Notice supplements those efforts by updating underwriting requirements to better reflect industry standards and best practices.

III. Risk Mitigation Measures

A. General

1. Definition of Affordable Housing.

   a. For purposes of applying the affordable housing underwriting standards and program requirements, as set forth below, "affordable" is defined as: (a) projects that have a recorded regulatory agreement in effect for at least 15 years after final endorsement, (b) projects that meet at least the minimum Low Income Housing Tax Credit (LIHTC) restrictions of 20% of units at 50% of the Area Median Income (AMI), or 40% of units at 60% of AMI, with economic rents (i.e. the portion paid by the tenants) on those units no greater than rents on those units no greater than LIHTC rents, and (c) mixed income projects if the minimum low income unit rent and occupancy restrictions and regulatory agreement meet the above criteria.

   b. Projects need not use LIHTCs to qualify for affordable underwriting so long as they have, and are in compliance with, a recorded regulatory agreement imposing the minimum low income occupancy and restricted rent tests in (a), above, and having a term of at least 15 years after final endorsement.

2. Applicability of Underwriting Changes.

   Except where specified in this Housing Notice, the revised Section 221(d)(4) underwriting standards, reserve and processing requirements are applicable to transactions processed under the Section 220, 221(d)(3), 231 and 241(a) programs. This guidance does not supersede requirements for those programs on matters not addressed in this Housing Notice.

   The underwriting standards for projects that have project based rental assistance will apply for projects that meet the definition of Affordable Housing above, but also have project based rental assistance for greater than 90% of the units.

3. Changes in Debt Service Coverage Ratios and Loan Ratios.

   Loan amounts are the lesser of: a) the requested mortgage amount, b) the amount allowed by statutory limits, c) the amount supportable by debt service, or d) the amount supportable by the applicable loan ratio. The current and new debt service coverage ratios (DSCR) and loan ratios (LR) are listed in the tables below.

Changes to Debt Service Coverage Ratio (HUD 92264-A, Criterion 5)				
Section of the Act	**Current DSCR**	**New DSCR**	**Current Criterion 5 LR**	**New Criterion 5 LR**
221(d)(3) and 221(d)(4) with 90% or greater rental assistance- no change	1.11	1.11	90.0%	90.0%
221(d)(4): affordable	1.11	1.15	90.0%	87.0%
221(d)(4): market rate	1.11	1.20	90.0%	83.3%
221(d)(3) affordable transactions	1.05	1.11	95.0%	90.0%
223(f) refinance of a Section 202 property	1.11	1.11	90.0%	90.0%
223(f) with 90% or greater rental assistance	1.176	1.15	85.0%	87.0%
223(f) affordable	1.176	1.176	85.0%	85.0%
223(f) market rate refinance or acquisition	1.176	1.20	85.0%	83.3%

Note: The Debt Service Coverage Ratios have been rounded to two or three decimal places for presentation purposes.

Changes to Value / Cost Loan Ratios				
Section of the Act	**Current Criterion 3 LR**	**New Criterion 3 LR**	**Current Criterion 7 LR**	**New Criterion 7 LR**
221(d)(3) and 221(d)(4) with 90% or greater rental assistance	90.0%	90.0%	N/A	N/A
221(d)(4): affordable	90.0%	87.0%	N/A	N/A
221(d)(4): market rate	90.0%	83.3%	N/A	N/A
221(d)(3) affordable transactions	100.0%	95.0%	N/A	N/A
223(f) refinance of a Section 202 property	90.0%	90.0%	N/A	N/A
223(f) with 90% or greater rental assistance	85.0%	87.0%	85%	87%
223(f) affordable	85.0%	85.0%	85.0%	85.0%
223(f) market rate refinance	85.0%	83.3%	N/A	N/A

223(f) market rate acquisition	85.0%	83.3%	85%	83.3%

There is no change to the current criterion 10 loan ratio for cash out refinancing.

Section 220 projects underwritten to the maximum commercial space or commercial income allowed by the program must be underwritten to market rate standards even if all or some of the housing units are affordable. Section 220 projects with both commercial space and commercial income less than the maximum allowed in the program can be treated as affordable so long as they meet the definition in Section III.A.1 above.

4. Mortgage Credit Analysis and Terrorism Check of Principals

   a. Existing published guidance, for example Handbook 4470.1 Chapters 1 & 3, and Handbook 4565.1 Chapter 6 paragraph 6-9, provide requirements of balance sheets and supporting schedules for the single asset entity mortgagor, plus its principals. Principals in this context are defined as those parties subject to Previous Participation Active Partners Performance System (APPS/2530) review, see 24 CFR 200.215.

   b. Mortgage credit review of a Limited Liability Company (LLC) follows a similar equity and control standard for principals in a Limited Partnership. Managing Members (analogous to a General Partner) and Members with an aggregate interest of 25 percent or greater are subject to mortgage credit review.

   c. Given the increased possibility for principals to be in material adverse financial positions as potentially over-leveraged short term debt comes due in the next several years, the Lender's credit review is particularly important. Generally, the Lender and HUD have exercised discretion in the extent of mortgage credit review where the single asset mortgagor entity is fully funded. Because of concerns about the impact of volatile real estate fundamentals, and the lack of liquidity in the commercial real estate financing markets, this Housing Notice is emphasizing the need for mortgage credit review by the Lender on all principals and affiliates, whether or not the single asset mortgagor entity is fully funded. The Lender's mortgage credit review must include:

      - The balance sheets for all principals should, in addition to other relevant schedules, contain a Schedule of Real Estate Owned, and a Schedule of Mortgage Debt. Sample templates of these schedules are attached.
      - The Lender's mortgage credit review and Firm Commitment submission should address the creditworthiness of all principals, and contain a written analysis of the financial position and contingent liabilities, particularly all mortgage debt with near or intermediate term balloon payments (i.e. within the next 5 years).
      - The Lender's analysis of the various properties' net operating income, outstanding indebtedness, valuation estimates etc., with details supporting the Lender's assessment of the likelihood of successfully refinancing projects with maturing balloon debt, assuming current capital markets conditions and the current availability of alternative long term financing sources.

- The Lender's analysis should reconcile the data, and come to a conclusion as to the principals' creditworthiness. Particular attention should be given to principals with a history or anticipated incidence of adverse credit actions including (but not limited to) bankruptcies, foreclosures, or a pattern of renegotiating debt.
- A financing plan for any shortfall or anticipated lack of available credit should be provided. Both conventional financing and other FHA insured loans should be included in this analysis.

d. The US Patriot Act requires Office of Foreign Assets Control (OFAC)/Terrorism checks and verifications on principals. These checks must be completed and documented prior to Initial Endorsement, whether or not the Lender is a regulated financial institution. OFAC requirements are administered by the Department of the Treasury, and Lenders should refer to Treasury's website, http://www.ustreas.gov/offices/enforcement/ofac, if they have questions.

5. Concentration of Principal Risk.

Particular attention and additional scrutiny will be given in cases where principals have greater than $250,000,000 of outstanding FHA insured debt. Based on their review of the principals' Schedule of Real Estate Owned, the lenders must identify principals that exceed this $250,000,000 threshold. Lenders will need HUD pre-approval before such principals or Borrowers may apply for additional insurance commitments; further guidance will be issued separately to address the process for obtaining HUD approval.

B. Program Changes – Section 223(f) Program Underwriting Guidelines

1. Occupancy Standards

Projects must have an average physical occupancy rate of at least 85%. For market rate properties, the maximum underwritten physical occupancy rate is 93%. For affordable properties, the maximum underwritten physical occupancy is 95% if a property has: a) at least 90% of units covered by a rental assistance contract, or b) affordable rent restrictions on 100% of units with all unit rents at least 20% below comparable market rents.

Projects must demonstrate a pattern of stable physical occupancy, i.e. the average occupancy standards noted above, for a period of six months prior to submission of the Firm Commitment application, and maintain that occupancy through to the date of Initial/Final Endorsement. Continued occupancy consistent with the underwriting conclusions must be documented with an updated rent roll no more than 30 days prior to closing. The following special condition will be added to Firm Commitments:

> *The Borrower must submit an updated, certified rent roll detailing the occupancy level at the project. The rent roll must be dated no more than 30 days prior to endorsement. If HUD determines that the updated rent roll shows a significant change in occupancy from that submitted at the time of*

application and that was assumed in the loan approval, then this Commitment shall be of no force or effect and will be cancelled by HUD.

The occupancy provision described above applies to all Section 223(f) applications, with the exception of those applying for a 3-year rule waiver. The provisions for sustaining occupancy requirements issued in previous guidance are superseded by this Notice as follows:

> Occupancy standards for refinancing under the 3-year rule waiver, including for qualifying condominium buildings that operate as a rental project, are as follows: a) meet the minimum sustaining occupancy requirements for 3 months prior to endorsement, and b) fund a debt service reserve of 4 months principal, interest and Mortgage Insurance Premium (MIP), which will be released once the property has maintained break-even occupancy for 6 consecutive months after Initial/Final endorsement. HUD Mortgage Credit staff will consult with Asset Management staff prior to approving the release. 3-year rule waiver properties that have sustained an average minimum 85% physical occupancy for 6 months prior to application submission and maintain it during application processing, with confirmation by a rent roll submitted within 30 days of endorsement, will not be required to fund a debt service reserve.

2. Market Study

Section 223(f) proposals typically do not require a market study separate from that contained in the appraisal, however in volatile or declining markets, the Lender should consider and may be required to obtain such a study to support the underwriting conclusions of market demand for the subject property over the loan term. Multifamily Program Center staff should consult with Economic Market Analysis Division (EMAD) in such cases.

3. Release of Cash / Equity from Loan Proceeds

The loan to value ratio (in criterion 10 of the HUD 92264-A) for cash out refinances remains unchanged at 80%. Fifty per cent (50%) of any cash out proceeds after funding transaction costs, including the assurance of completion requirements, must be held in escrow by the Mortgagee until the required non-critical repairs are completed and HUD approves the release.

4. Financial Statement's for Underwriting Section 223(f) Refinancing and Acquisition Projects.

To confirm the accuracy of the property financials, the Borrower must provide three years of tax returns for the project or borrowing entity. In addition, 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. The

Multifamily Hub Director may grant a waiver of this requirement for acquisitions. The CPA review is applicable to the most recent full year financial statement and Borrower certifications are acceptable for the required previous years' statements.

5. Past Due Payables and Project Liabilities.

   Past due accounts payable and outstanding liabilities for project operating expenses must be cleared and released, or otherwise fully satisfied, prior to or at loan closing. Examples of such items include deferred management fees, over-due utility bills or real estate taxes, or trade payables. These items are not to be included in the eligible debt basis in the calculation of the cost to refinance. If the transaction does not involve a Transfer of Physical Assets, and if approved by the Multifamily Hub Director, surplus cash notes may be established for payables owed to a related entity only.

6. Underwriter Site Inspection and Rental Lease Audit Requirement

   The Multifamily Accelerated Processing (MAP) approved underwriter must perform an on-site lease audit and physical inspection representing a sample of each unit type. 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.

   For projects 50 units or less: Inspect at least one of each unit type, to include a representative sample of 10% of the units.

   For projects between 51 and 250 units: Inspect at least one of each unit type, to include a representative sample of 10 units plus 5% of the total number of units greater than 50.

   For projects greater than 250 units: Inspect at least one of each unit type, to include a representative sample of 15 units, plus 2% of the total number of units greater than 250, for a maximum of 50 units.

   The Lender must compare the terms of the lease agreements to the rent roll, verifying the unit number, tenant name, lease commencement date, expiration date, concessions if any, and monthly rent, and confirm that this data is consistent with the assumptions used in the underwriting analysis.

7. Reserve for Replacement

   The minimum reserve for replacement deposit is $250 per unit per year or such higher amount as is indicated by the Property Capital Needs Assessment (PCNA), even with an initial deposit to the reserve for replacement escrow. Projects must obtain a new PCNA every 10 years, with the reserve for replacement deposit adjusted based on the results of the PCNA. HUD Asset Management staff must review and concur or non-concur on the deposit requirements. Development staff will consider this determination and make a final determination of the reserve requirements. The reserve schedule and deposit requirements required by the Firm Commitment will be applicable during the first ten year term of the mortgage.

8. Condominium Ownership Regimes

A project which was built and intended as condominiums, but is now operating or proposed to operate as a rental project, may be considered under Section 223(f) if the condominium regime is converted to a single owner with no individual unit ownership, and the property meets the other program guidelines, including the minimum occupancy standards.

Condominium ownership regimes and plots may be recorded if the property is otherwise operated as a rental project with a single ownership entity owning all the apartments. Separate condominium units may be established for commercial use and for housing use which must include all the residential apartments. The FHA insured loan must be secured by a mortgage on the rental apartment portion and any mortgageable commercial space. Joint use and maintenance agreements and easements between the FHA insured portion of the property and any separately demised condominium portion must be defined.

The Multifamily Hub Director may consider a waiver for a condominiumized building with a limited number of individually owned units if all the owned units are located in a separate building or in a separate section of a single building apart from the rental units. HUD will not consider a waiver if any ownership units are interspersed with the rental units.

C. Program Changes - Section 223(a) (7) Refinancing

1. Eligibility for MAP Processing

Section 223(a) (7) refinancing transactions (except those subject to the Memorandum of Understanding with the Office of Affordable Housing Preservation) may be processed under MAP and will be subject to the MAP processing time frames for 223(f) Firm Commitments.

2. Past Due Payables and Project Liabilities

Past due accounts payable and outstanding liabilities for project operating expenses must be cleared and released, or otherwise fully satisfied, prior to or at loan closing. Examples of such items include deferred management fees, over-due utility bills or real estate taxes, or trade payables. These items are not to be included in the eligible debt basis in the calculation of the cost to refinance. If not subject to a transfer of physical assets (TPA) and approved by the Multifamily Hub Director, surplus cash notes may be established for payables owed to a related entity only.

3. Reserve for Replacement and PCNA Requirement

A PCNA is required with submission of the application. The minimum reserve for replacement deposit is $250 per unit per year or such higher amount as is indicated by the

PCNA, even with an initial deposit to the reserve for replacement escrow. Projects must obtain a new PCNA every 10 years, with the reserve for replacement deposit adjusted based on the results of the PCNA. HUD Asset Management staff must review and concur or non-concur on the deposit requirements. Development staff will consider this determination and make a final determination of the reserve requirements. The reserve schedule and deposit requirements required by the Firm Commitment will be applicable during the first ten year term of the mortgage.

D. Program Changes - New Construction and Substantial Rehabilitation Program Underwriting Guidelines

The new construction and substantial rehabilitation multifamily programs affected by this Housing Notice are the Section 220, 221(d)(3), 221(d)(4), 231 and 241(a) programs.

1. <u>Application Fees</u>

FHA Application Fees remain $3 per $1,000 (30 basis points) of the mortgage amount. Market rate pre-applications must pay a non-refundable 15 basis point review fee, which fee will be credited to the 30 basis point Firm Commitment fee if an invitation letter is issued and a Firm Commitment application is submitted. Affordable housing transactions (as defined in Section III.A.1) that submit for two stage processing must pay the 30 basis point fee at the Firm Commitment stage, but will not be charged a fee for pre-application review.

2. <u>Pre-Application Exhibits</u>

The pre-application exhibits as described in existing guidance must include:

a) Preliminary appraisal work which includes a narrative rental and expense analysis with the submission of forms HUD 92274, 92273 and the 92264-T, if applicable and an estimate of land value for new construction projects (or "as is" value for substantial rehabilitation project) by comparable analysis. The complete appraisal with a cost approach may be submitted with the application for Firm Commitment.

b) The lender's assessment and preliminary evaluation of the sponsor's creditworthiness. To the extent the mortgagor entity and principals have been identified at this stage, initial information about the sponsor's experience, including a brief summary of mortgage credit qualifications and schedule of real estate owned and maturing debt should be provided with the pre-application.

3. <u>Market Studies</u>

For all new construction and substantial rehabilitation projects with significant tenant displacement, the appraisal and market study should be completed by different firms. This requirement includes LIHTC transactions with economic rents, which do not have project based rental assistance. The Hub Director can waive this requirement on a case-by-case basis, if it is clear the appraiser or appraisal firm is capable of performing both the appraisal analysis and a macro-economic market analysis, and if the strength of the market is not in question.

4. Underwritten Occupancy

   Underwritten physical occupancy is limited to 93% for market rate properties. If a property has: a) at least 90% of units covered by a rental assistance contract, or b) affordable rent restrictions on 100% of units with all unit rents at least 20% below comparable market rents, the maximum underwritten physical occupancy is 95%.

5. Number of Units

   Generally, HUD has allowed absorption periods up to 24 months. Due to volatility and weakness in the real estate markets, the absorption period used in estimating market demand for the proposed number of units will now be restricted to 18 months. Larger projects may phase additional units under a separate application for mortgage insurance (e.g. under Section 241(a).) An exception to the 18 month limitation on the absorption period may be considered by the Multifamily Hub Director for large high rise buildings. Such projects will be evaluated based on their own merit and may require a larger initial operating reserve to insure against slower than anticipated absorption.

6. Marketing, Leasing, and (if applicable) Relocation Plan

   All projects which require absorption of units at economic rents to achieve break-even occupancy must submit a detailed marketing and leasing plan and budget that has been reviewed and confirmed by the proposed property management company. The plan must discuss when marketing efforts will begin, when the leasing office and model units will be opened, how the leasing office will be staffed, and the project's marketing and advertising strategy. The plan must address timing of the construction progress schedule with respect to egress and ingress into the project, landscaping, and access to amenities. These items are in addition to those required by the Affirmative Fair Housing Marketing Plan.

   For substantial rehabilitation projects involving temporary relocation or displacement of tenants, the plan must address details of timing, funding and management of the relocation process.

7. Cash Out from Land Equity

   If land, or "as is" value for a substantial rehabilitation project, is contributed to meet the sponsor's equity requirement, any cash out from the land equity above what is required at initial endorsement must be deferred until the project is complete and it has demonstrated to the HUD field office's satisfaction that the project has achieved 6 months of break-even occupancy. This does not prevent applying land value equity to fund operating deficit or working capital escrows, or other cash requirements at initial endorsement.

8. Construction Contract Retainage

Currently, a holdback of 10% of the construction contract amount is retained for each construction advance. This notice revises the requirements for construction retainage if:

a) The Contractor has no identity-of-interest with the owner greater than a 5 percent equity interest,

b) If applicable, prior written consent from the surety company must be attached to the request for release, and

c) There are no questions regarding the contractor's performance concerning the quality of work, compliance with the contract and any change orders or work in progress.

Assuming these conditions are met, the existing standard of 10% retainage will be required until 50% completion. After that, the requirement will be 5% retainage until 75% completion and 2.5% retainage until the loan reaches final endorsement.

9. Contingency Escrow Requirements for Substantial Rehabilitation.

Construction contingency requirements for all substantial rehabilitation projects are increased to 10-15% of construction cost. The Borrower may elect to apply any funds remaining in the substantial rehabilitation construction contingency account after completion of the approved rehabilitation, to: a) further improvements, betterments or upgrades to the property, or b) reducing the mortgage balance. If excess funds from contingency are used for betterments, those additional improvements will not be considered as the basis for a request for an increased mortgage amount.

10. Furniture, Fixture and Equipment (FF&E) in Cost Basis

Reasonable costs of Furniture, Fixture and Equipment may be included in the mortgageable project costs.

11. Reserve for Replacement and PCNA Requirement

For new construction or substantial rehabilitation projects, the minimum reserve for replacement deposit will be the higher of:

a) the amount currently required by the Section 221(d) (4) program, or
b) $250 per unit per year.

In order to avoid over-funding reserve for replacement accounts for high cost properties with low reserve for replacement needs, waivers of the formula based calculation of reserve for replacement deposit will be considered if the formula approach results in a per unit per annum deposit requirement of greater than $500. The Multifamily Hub Director's approval of a waiver request must be supported by the Lender's third-party Architecture, Engineering and Cost Analyst documentation and conclusion that a lesser amount is justified.

Projects must obtain a new PCNA every 10 years with the reserve for replacement deposit adjusted based on the results of the PCNA. HUD Asset Management staff must review and concur or non-concur on the deposit requirements. Development staff will consider this determination and make a final determination of the reserve requirements. The reserve schedule and deposit requirements required by the Firm Commitment will be applicable during the first ten year term of the mortgage.

12. <u>Operating Deficit Escrow Requirements for New Construction/ Substantial Rehabilitation.</u>

The operating deficit escrow provides funding for operating expenses and debt service when net income is not available during the initial lease up period. This escrow is not mortgageable and the unused portion is returned to the Borrower. The appraiser will calculate the number of months for an operating deficit and the estimated amount for that period of time, according to outstanding guidance. The underwriter will analyze the appraiser's estimate and may adjust it if appropriate.

There is no increase in the operating deficit escrow requirements described in the MAP Guide for substantial rehabilitation projects with at least 90% project based rental assistance. For LIHTC projects with a funded operating deficit reserve held by the partnership (even though controlled by the investor and not by HUD or the Lender), the funded reserve will be credited towards the increased reserve requirements. The FHA controlled accounts must still meet the current operating deficit requirements as described in existing guidance.

For market rate or affordable new construction, and for substantial rehabilitation projects in which there will be significant tenant displacement resulting in negative cash flow during the rehabilitation period, operating deficit escrows will be the <u>greater of</u>:

a) What the appraisal and underwriting analysis determines to be appropriate, or

b) Three percent (3%) of the mortgage amount, or

c) Four (4) months debt service (Principal & Interest and Mortgage Insurance Premium) if the property is a garden apartment, or six (6) months debt service (Principal & Interest and Mortgage Insurance Premium) if the property is an elevator building where a single Certificate of Occupancy must be issued before any of the units or any of the entire floors can be rented.

HUD will consider lender requests for Initial Operating Deficit draws during lease-up. Lender requests must be accompanied by: a) a review and analysis of the monthly accounting reports detailing progress on lease up as compared to the lease up projections used in underwriting, and b) an updated calculation of the sufficiency of the escrow. This analysis and calculation is particularly important if the project is experiencing substantial variations from its lease up projections. HUD Mortgage Credit staff will consult with

Asset Management staff prior to approving the release. Unused amounts will be released upon the Lender's request at the later of 12 months after final endorsement or when the project has demonstrated to the HUD field office's satisfaction that the project has achieved 6 months of break-even occupancy. For garden apartment projects consisting of separate buildings, each of which is leased up separately, HUD will consider partial releases of the operating deficit escrow as individual buildings achieve 6 months of break-even occupancy. The Lender is responsible for insuring funds are released solely for project operating needs.

Other than as noted in this Housing Notice, outstanding guidance for the operating deficit escrow remains in effect.

13. Working Capital Escrow Requirements for New Construction/ Substantial Rehabilitation.

There is no increase in the working capital escrow requirements described in the MAP Guide for substantial rehabilitation projects with at least 90% project based rental assistance. For LIHTC projects with a funded working capital reserve held by the partnership (even though controlled by the investor and not by HUD or the Lender), the funded reserve will be credited towards the increased reserve requirement, although the FHA controlled account must still meet the current working capital escrow requirements as described in existing guidance.

The working capital escrow requirement for new construction transactions will be 4% of the mortgage amount, half of which will be a construction contingency for cost overruns and approved change orders. A separate section to the working capital escrow will govern the 2% construction contingency. The construction contingency portion of the escrow will be refunded to the developer at final endorsement if not used. Change orders funded from the contingency portion of the working capital escrow will not be considered as the basis for a request for an increased mortgage amount.

As is the case with operating deficit escrows, these funds are not mortgageable and the unused portion will be returned to the Borrower if not needed. The working capital portion of the escrow will be released upon the Lender's request at the later of 12 months after final endorsement or when the project has demonstrated to the HUD field office's satisfaction that the project has achieved 6 months of break-even occupancy.

14. Insurance Upon Completion

Projects that apply for insurance upon completion (without insured construction advances) must meet the operating deficit escrow and working capital requirements for projects with insurance of advances as outlined in this Notice except for the extra 2% construction contingency section of the working capital requirement.

15. Other Issues

Except where specified in this Housing Notice, the revised Section 221(d) (4) underwriting standards, reserve and processing requirements are applicable to transactions processed under the Section 220, 221(d)(3), 231 and 241(a) programs. This guidance does not supersede requirements for those programs on matters not addressed in this Housing Notice.

Break-even occupancy in the discussion of working capital and initial operating deficit escrow releases is defined as 1.0 debt service coverage, based on all sources of project income including ancillary income, for 6 consecutive months.

The same requirements for condominium ownership regimes described above in the Section 223(f) program guidelines apply to proposed new construction and substantial rehabilitation projects.

IV. Processing Improvements

A. New Project Concept Meetings

All Section 220, 221(d)(3), 221(d)(4), 231 and 241(a) projects (both market rate and affordable) must participate in a concept meeting with the program center, either in person or by teleconference, where the project has an early review before submitting a pre-application or direct to Firm application. Concept meetings are not required, but are strongly encouraged for Section 223(f) transactions. The submissions required from the Lender for a concept meeting review should address the following items, to the extent possible at this preliminary stage.

New Construction/Substantial Rehabilitation Proposals:

- Section of the Act
- Number of market rate and affordable units
- Projected mortgage amount
- Basic information on developer and principals
- Management company
- General contractor
- Previous HUD experience
- Geographic location with map
- Photographs of the subject and immediate surroundings
- Site improvements (existing/proposed)
- Commercial component – discuss potential tenants
- Amenities
- Community / city / state support
- Green / sustainability Issues
- Development status (e.g., have any permits/approvals been obtained?)
- Discuss general market conditions, competitive properties and comparables
- Environmental issues
- Potential risks and mitigating factors
- Any anticipated waiver requests

Refinancing or Acquisition Proposals:

- Section of the Act
- Number of market rate and affordable units
- Projected mortgage amount
- Mortgage term and estimated remaining economic life
- Refinance or acquisition
- Basic information on developer and principals
- Management company
- Previous HUD experience
- Geographic location with map
- Photographs of the subject and immediate surroundings
- Actual and effective property age / class
- Physical condition
- Prior / proposed renovations (per unit cost)
- Discuss eligibility for Section 223(f) versus substantial rehabilitation
- Amenities
- Existing debt / cash out
- Current occupancy (physical / economic)
- Income and expenses
- Discuss green / sustainability issues as appropriate
- Discuss general market conditions, competitive properties and comparables
- Environmental issues
- Actual / potential risks and mitigating factors
- Any anticipated waiver requests

The Lender should complete the form HUD-92013, "Application for a Multifamily Housing Project" to the extent possible.

Where practicable, site visits by the appropriate Program Center staff are encouraged The Program Center will respond in writing (either by e-mail or more formally) within 5 working days of the concept meeting/site visit. Depending on the completeness and quality of the submission, the Program Center may recommend or not recommend that the Lender make an application, or they may request additional information or specify conditions or recommendations for the Lender and sponsor to consider. Consideration should be given to the effect on other FHA-insured projects in the subject's market area that are already in the pipeline, developer experience and overall feasibility based on the exhibits and information presented.

B. <u>Two Stage Processing</u>

Market rate Section 220, 221(d), and 231 applications must be submitted under 2 stage processing (i.e., including a Preapplication submittal) and may not apply directly for a Firm Commitment. The Hub Director may waive 2 stage processing and allow a direct to Firm application for a stable, occupied market rate substantial rehabilitation property that, during the rehabilitation period, will not have: a) major rehabilitation or unit reconfiguration, b) tenant displacement except for short periods during interior rehabilitation of a unit, c) a reduction in current occupancy levels, d) negative cash flow, or e) for properties in stable markets for which a Preapplication Invitation letter recently expired on a substantially unchanged proposal. Affordable properties (as defined above), or those with 90% or more rental assistance, may submit a Section 221(d) (4) application directly for Firm Commitment.

C. Partial Electronic Submission

Lenders must submit an original and 1 hard copy of the underwriting file, exhibits and third party reports and must submit an electronic version of these materials on a disc or a removable drive.

D. MAP and Traditional Application Process (TAP) Processing

All MAP eligible projects must be submitted using MAP processing and may not be submitted under TAP.

E. 2530 Approval

Firm Commitments or Invitation letters may be issued conditioned on 2530/APPS approval, assuming no critical findings and that the 2530 flags can be resolved without being presented to the Multifamily Participation Review Committee.

F. Market Studies

Market studies are not required for properties with at least 90% of units covered by a rental assistance contract and no rent increase.

V. Implementation

A. Changes to the Section 220, 221(d)(3), 221(d)(4), 231 and 241(a) programs will be implemented as follows: i) 60 days after the effective date of the Housing Notice for any new pre-applications, (existing or previously submitted pre-application submissions are covered under iii. below), ii) up to 120 days 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, or iii) up to 90 days after the effective date of the Notice for any complete new applications for direct to Firm Commitments.

B. Changes to the Section 223(f) and 223(a) (7) programs will be implemented 60 days after the effective date of the Notice for any applications or application fees not submitted before that date.

C. Incomplete applications that are submitted before the implementation dates will be returned to the Lender and the revised underwriting standards will be applicable upon resubmission. Materially deficient applications submitted by a Lender pre-maturely in order to avoid application of more stringent underwriting parameters will be referred to the Lender Quality Monitoring Division for review.

D. Any extensions of the implementation dates for individual projects must be approved by HUD Headquarters and will only be considered in cases the Lender and Borrower have demonstrated to HUD's satisfaction they have done everything within their control to meet the deadlines imposed and that a short extension is warranted to permit the transaction to achieve closing.

VI. Conclusion

The Department will continue to monitor market conditions and the impact of these risk mitigation measures. Additional guidance will be published based on experience and industry input. Questions relating to this Housing Notice should be directed to Joyce Allen, Director of Multifamily Development, at (202) 402-2471. Persons with hearing or speech impairments may access this number via TDD/TTY by calling 1-877-TDD-2HUD (1-877-833-2483).

_______________/S/_____________________
David H. Stevens
Assistant Secretary for Housing –
Federal Housing Commissioner

Attachments:

Attachment A – Sample Schedule of Real Estate Owned
Attachment B – Sample Schedule of Mortgage Debt

RISK MITIGATION CASE STUDIES

Real life examples of why Housing Notice H2010-11 "HUD Multifamily Risk Mitigation" came to fruition

(Honest, we ain't makin' this stuff up!)

Case #1
221(d)(4) Sub Rehab

- Substantial Rehabilitation of a 717 unit elevated urban apartment building
- 80% of the units to be LIHTC rent restricted
- Market Vacancy of approximately 4%
- Loan requested was approximately $45,000,000
- $11,000,000 in Tax Credit Equity
- Replacement Cost of approximately $57,000,000 for a LTC of 82%

Underwriter's Recommendation

- "we have determined that there is a market demand, the site is suitable, rent and expenses appear within the acceptable range of those in the market area. We believe this represents a feasible project and is an acceptable risk to the Department."

But…..

- LQMD found:
  - that the owner's ability and experience in the development and rehabilitation of distressed properties was questionable. The applicant had no experience as an owner.
  - The general contractor who was a principal of the mortgagor. The GC had no experience in this type of complex rehabilitation.
  - Project expenses were significantly higher than underwritten and underwritten rents were not attained.

Making Matters Worse

- **The project's sub-rehabilitation was under scoped by the owner and architect**.
- HUD inspection reports reveal that nearly 100 change orders were submitted to complete the sub-rehab at a substantial cost increase and it still did not include costs for unforeseen issues and asbestos abatement.
- Adequate measures for security were not included, and security issues persistently plagued the project. Security costs were 10 times greater than budgeted.

Fuel to the Fire

- **The general contractor consistently proceeded to do change order work without HUD prior approval of change orders and without sufficient funds budgeted. Construction contingency was woefully inadequate.**
- Disputes between the contractor and owner resulted in liens being placed against the property. Construction was not completed until approximately three years behind the original contract completion date.

And then…

- The original contractor (also the owner) did not meet HUD’s working capital requirements.
- Due to financial weakness and lack of experience, the contractor entered a joint venture agreement with another contractor to placate the lender and HUD.
- The second QC was then removed prior to initial endorsement of the project without notifying the lender or HUD.

The final straws…

- Both the Appraiser and the lender concluded that “no operating deficit is needed for the project.
- The managing member of G.P., decided against using a qualified manager and did not inform the lender or HUD of the changes in management agent. The high turnover of property management destabilized the lease up and slowed achieving the underwritten rent.

The final straws

- Delays in construction resulted in problems associated with the relocation of tenants during rehabilitation. Because the managing agent (a related entity to the ownership) did not have prior experience in tenant relocation, the relocation plan was not executed effectively which negatively affected the construction progress.

The Result

- Despite the tax credit equity and restricted rents, the project was submitted for claim for a substantial loss to the Department……

HN 2010-11; Section D 2 b:

-
  - The lender’s assessment and preliminary evaluation of the sponsor’s creditworthiness. To the extent the mortgagor entity and principals have been identified at this stage, **initial information about the sponsor’s experience, including a brief summary of mortgage credit qualifications** and schedule of real estate owned and maturing debt should be provided with the pre-application.

HN 2010-11; Section D6:

- All projects which require absorption of units at economic rents to achieve break-even occupancy must submit a detailed marketing and leasing plan and budget that has been reviewed and confirmed by the proposed property management company
- For substantial rehabilitation projects involving temporary relocation or displacement of tenants, the plan must address details of timing, funding and management of the relocation process.

HN 2010-11; Section D9:

- Construction contingency requirements for all substantial rehabilitation projects are increased to 10-15% of construction cost. If excess funds from contingency are used for betterments, those additional improvements will not be considered as the basis for a request for an increased mortgage amount.

HN 2010-11; Section D12:

- For market rate or affordable new construction, and for substantial rehabilitation projects in which there will be significant tenant displacement resulting in negative cash flow during the rehabilitation period, operating deficit escrows will be the greater of:
  - a) What the appraisal and underwriting analysis determines to be appropriate, or
  - b) Three percent (3%) of the mortgage amount, or
  - c) Four (4) months debt service if the property is a garden apartment, or six (6) months debt service if the property is an elevator building where a single Certificate of Occupancy must be issued before any of the units or any of the entire floors can be rented.

223(f) Case Study #1

The project is a suburban garden apartment building, constructed in 1971 and consisting of 63 buildings. It contained 250 revenue and 2 non-revenue units

Appraised Value:	$10,250,000
Mortgage Amount:	$8,704,000
LTV	85%

Underwriter’s Recommendation

“The PCNA report identifies the property to be in overall good condition. We have determined that the property is not in need of substantial rehabilitation…..the loan represents an acceptable risk to the Department”

But….

- LQMD Found:
  - Serious neglect by the owner's affiliated management company.
  - The management took no action to prevent vandalism, nor did they maintain the buildings and grounds.
  - Most units were boarded-up and had been seriously vandalized. We saw broken unit entry doors and windows in most units of the 63 buildings.
  - Throughout the property, appliances, copper wiring and pipes were taken from the units.

And….

- Water lines were damaged in two buildings. Water was pouring from the second floor through the ceiling to the first floors before exiting the building through the weep holes in the brick exterior.
- Serious mold and water damage in these buildings that would be a health hazard for the residents.
- Pooling of raw sewage in large areas between two buildings.
- No active on-site management presence. It was evident that the project owners and management entity have essentially deserted the project.

Compounding the Issue

Actual Occupancy History

Jun- 01	73.6%
Dec -01	62.4%
Mar- 02	58.8%
Dec-02	53.6%
Mar-03	50.1%
Dec- 03	65.6%
Underwritten Occupancy in 04	**85.6%**

So What Happened after endorsement?

Post Endorsement Occupancy	
Underwritten	85.6 %
Actual	
▪ Dec 04	65%
▪ Jun 05	52%
▪ Dec 05	54%

Ultimate Result

- The loan experienced a rolling default since September 2005. The lender assigned the mortgage to HUD in 2008. HUD paid final claim in 2008 and sold the property in foreclosure sale in 2009. The Department suffered a significant loss from the foreclosure sale of the project.

HN 2010-11; Section III B 1

- Occupancy Standards:
  - Projects must have an average physical occupancy rate of at least 85%. For market rate properties, the maximum underwritten physical occupancy rate is 93%.
  - Projects must demonstrate a pattern of stable physical occupancy, i.e. the average occupancy standards noted above, for a period of six months prior to submission of the Firm Commitment application, and maintain that occupancy through to the date of Initial/Final Endorsement.

HN 2010-11; Section III B7:

- Underwriter Site Inspection and Rental Lease Audit
  - The Multifamily Accelerated Processing (MAP) approved underwriter must perform an on-site lease audit and physical inspection representing a sample of each unit type.
  - The Lender must compare the terms of the lease agreements to the rent roll, verifying the unit number, tenant name, lease commencement date, expiration date, concessions if any, and monthly rent, and confirm that this data is consistent with the assumptions used in the underwriting analysis.

223(f) Case Study #2

- 252 Unit Suburban Garden Apartment Property; 55 one-bedroom units, 158 two-bedroom units, and 39 three-bedroom units.
- The owner purchased the property for $4,900,000
- The Lender indicated the owner made substantial capital improvements of $850,000 to reposition the property
- Total Owner Investment : $5,750,000
- Appraised Value: $5,950,000
- Mortgage Amount: $5,057,500
- LTV: 85%

Underwriter's Recommendation

- The Underwriter acknowledged a declining market, but recommended the loan as a good credit risk.
- Specific justifications were that the property was in a good state of repair and was occupied by high quality tenants.
- Underwriter's Narrative offered the opinion that the market would improve and that the rental rate would slowly rise.

But…..

- **At time of LQMD review, the property was 50% occupied**
- The rents were below underwritten rents.
- Rent roll revealed that many of the residents were past due
- the market area was experiencing a high economic vacancy rate and high crime rate

And…

- The property was in extreme disrepair
- Many units were unsanitary, lacked usable fixtures and were uninhabitable.
- A number of vacant units were being used by squatters

What went Wrong?

- LQMD found that the Underwriter did perform the required financial analysis, but it was inaccurate, incomplete and very questionable. In each of the previous three years, the project was operating at significant losses and had negative working capital and net worth.

What went wrong?

- Although the third party PCNA report identified the property as being in “good condition” the LQMD team found the property in an extremely poor condition.
- The underwriter ignored the prevailing market conditions which had no end in sight at the time.
- Major industry had been moving out of the market for some time.

Ultimate Result

- The property was submitted for claim, resulting in a significant loss to the Department.

In Hindsite

- The "post default" analysis by the lender indicated that:
  - the market's non-farm employment fell by 2.4% from over the last year and that residents were significantly leaving the market area.
  - Per REIS Reports, the most recent quarter reported a negative unit absorption and vacancy rose 20 basis points.
  - Asking Rents had been stagnant for 5 years.
  - LQMD determined that deteriorating rental market condition was a major factor contributing to the project default that had been reflected in the project's three years' financial and occupancy history.

HN 2010-11; Section III B1:

- Occupancy Standards:
  - Projects must have an average physical occupancy rate of at least 85%. For market rate properties, the maximum underwritten physical occupancy rate is 93%.
  - Projects must demonstrate a pattern of stable physical occupancy, i.e. the average occupancy standards noted above, for a period of six months prior to submission of the Firm Commitment application, and maintain that occupancy through to the date of Initial/Final Endorsement.

HN 2010-11; Section III B2:

- Market Study:
  - Section 223(f) proposals typically do not require a market study separate from that contained in the appraisal, however in volatile or declining markets, the Lender should consider and may be required to obtain such a study to support the underwriting conclusions of market demand for the subject property over the loan term.

HN 2010-11; Section III B4:

- Financial Statements:

  To confirm the accuracy of the property financials, the Borrower must provide three years of tax returns for the project or borrowing entity. In addition, 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.

HN 2010-11; Section III B7:

- Underwriter Site Inspection and Rental Lease Audit
  - The Multifamily Accelerated Processing (MAP) approved underwriter must perform an on-site lease audit and physical inspection representing a sample of each unit type.
  - The Lender must compare the terms of the lease agreements to the rent roll, verifying the unit number, tenant name, lease commencement date, expiration date, concessions if any, and monthly rent, and confirm that this data is consistent with the assumptions used in the underwriting analysis.

PP 174-183

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.

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

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.

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

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.

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

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.*

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

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).*

Question 3: *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 3: *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 4: *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 4: *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 5: *I have a question about applying the new Risk Mitigation Notice/Mortgagee letter to a specific transaction. Who should I contact?*

Answer 5 : *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 6: *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 6: *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.*

Question 7: *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 7: *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 8: *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 8: *No*

Question 9: *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 9: *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:

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

Question 10: *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.*

monitored by public Ent Agy

Answer 10: *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.*

Question 11: *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 11: *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 12: *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 12: *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 13: *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 13: *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.*

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

Re-edited as Q17 in Q+A 31

Question 14: *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 14: *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.*

Question 15: *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 15: *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 16: *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 16: *The MF Hub or Program Center Director makes the decision based on the recommendation of HUD's construction inspector.*

Question 17: *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 17: *The lender has discretion subject to the HUD field office approval.*

Question 18: *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 18: *This question and answer remain under consideration.*

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

Question 19: *Section IV.D – Will TAP processing still be allowed in cases where the Lender has an identity of interest that prohibits MAP processing?*

Answer 19: *Yes.*

Question 20: *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 20: *Yes. See the Q/A #9 published 7/15/10 which supersedes Q/A's 3, 4 and 5.*

ouch
delete
Reference

Question 21: *Specific Timing Case #2 I have another Invitation Letter that was issued on March 10, 2010 (Crown Ridge Apts. in Lufkin, TX) 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 21: *See the Q/A #9 published 7/15/10 which supersedes Q/A's 3, 4 and 5.*

Question 22: *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 22: *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 23: *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 23: *See the Q/A #9 published 7/15/10 which supersedes Q/A's 3, 4 and 5.*

Question 24: *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 24: *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 25: *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 25: *The transaction costs are those which are mortgageable costs.*

Question 26: *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 26: *This question and answer remain under consideration.*

Where is 27, 28, 29?

FHA Multifamily
Risk Mitigation Strategy

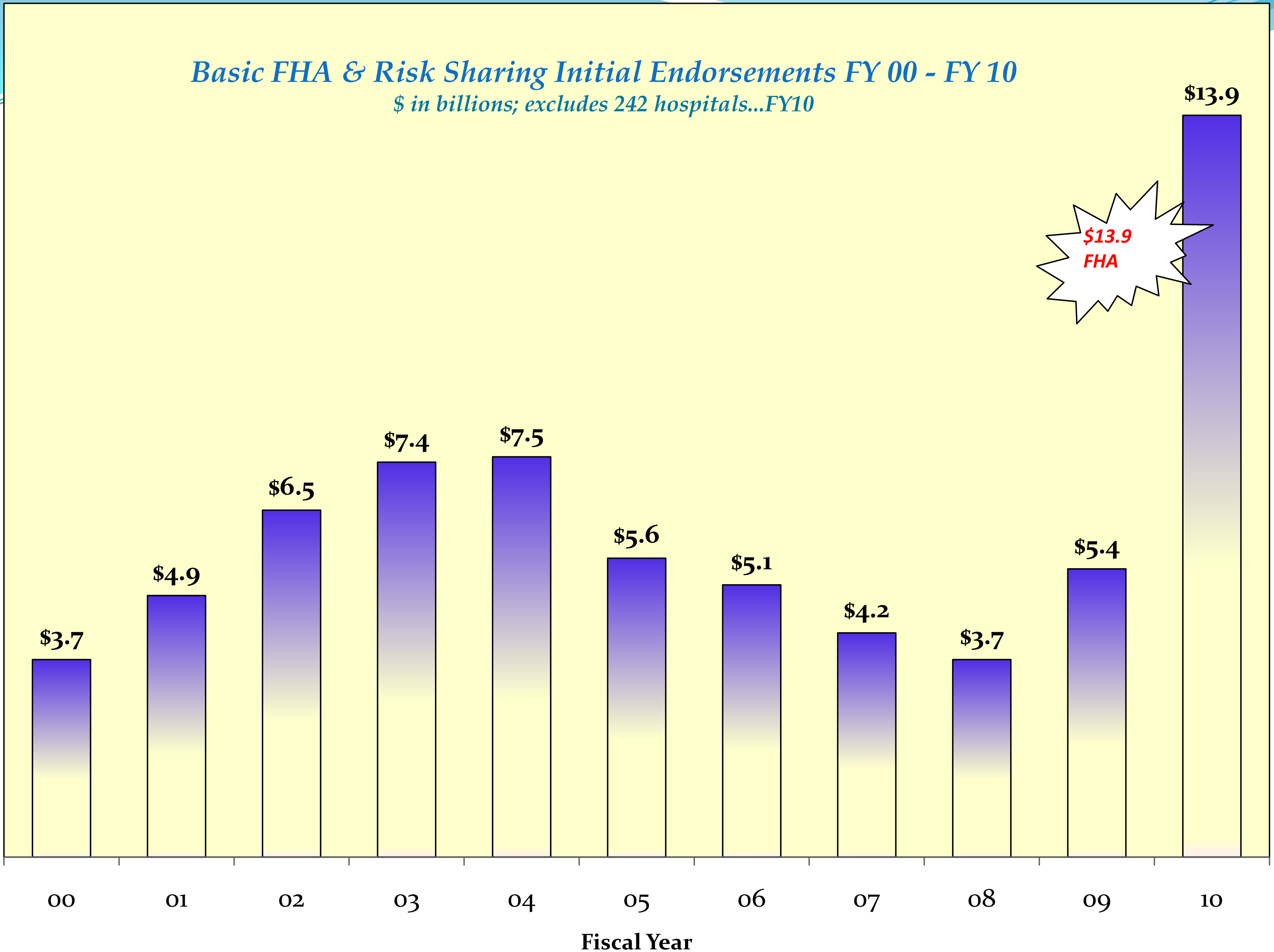
MAP Training
HUD HQs – October 2010

FHA Multifamily Risk Mitigation

- Why the changes:
  - To reduce risk to the FHA insurance fund in light of
    - Deterioration in real estate fundamentals
    - Dramatic increase in volume

FHA Multifamily Risk Mitigation

- Market Conditions Demand Response
  - Multifamily's Response:
    - Improved oversight
    - Improved credit risk management
    - Improved processing



Basic FHA & Risk Sharing Initial Endorsements FY 00 - FY 10
$ in billions; excludes 242 hospitals...FY10
$3.7
$4.9
$6.5
$7.4
$7.5
$5.6
$5.1
$4.2
$3.7
$5.4
$13.9
$13.9
FHA
00
01
02
03
04
05
06
07
08
09
10
Fiscal Year

1249 Projects, $17.5 Billion in MF Processing Pipeline

722 Refinancings

527 New Construction/Sub Rehab

FHA Multifamily Risk Mitigation

- How risk will be mitigated:
  - Counterparty relationships
    - Lenders/GMNA issuers
    - Borrowers
- Tightened Borrower Requirements:
  Enhanced Reviews and Concentration Analysis

FHA Multifamily Risk Mitigation

- Credit Culture
- Loan Committee
- Standardization

FHA Multifamily Risk Mitigation

Implementation

- Housing Notice 2010-21 (and Mortgagee Letter 2010-11)
  - 17 pages with attachments
  - Q & As

- Transition issues
  - Be fair – "grandfather"
  - Be quick

FHA Multifamily Risk Mitigation

Section IV – Processing Improvements

- Concept Meetings
- Two Stage processing
- Electronic Submission
- MAP not TAP
- Firm Conditioned on 2530
- No Market Study for 90-100% Section 8

FHA Multifamily Risk Mitigation

Section III, Risk Mitigation, Subsection A - General.

- Definition of Affordable Housing
- Which Programs are affected
- Change in Ratios

FHA Multifamily Risk Mitigation

Section III, Risk Mitigation, Subsection A - General.

- Mortgage Credit Review
  - Who is a principal?
  - LLCs
  - REO schedules
  - OFAC

- Borrower Concentration

Risk Mitigation HN/ML

Section III.C. – Section 223(a)(7)

- MAP
- Past Due/Project liabilities
- PCNA and R4R requirements

- REO Schedules / Credit Review NOT applicable
- No changes to Loan Ratios etc.
- Abbreviated Loan Committee presentation

BREAK

Noon – 1pm

New Construction / Sub Rehab

UNDERWRITING REVIEW

Risk Mitigation HN/ML

Section III.D. – Section 221(d)(4) – NC/SR

- App Fees
- Preapp requirements expanded

Risk Mitigation HN/ML

Section III.D. – Section 221(d)(4) – NC/SR

- Market Study and Appraisal conducted by separate firms

Risk Mitigation HN/ML

Section III.D. – Section 221(d)(4) – NC/SR

- Occupancy standard
- # of Units – i.e., absorption period

Risk Mitigation HN/ML

Section III.D. – Section 221(d)(4) – NC/SR

- Marketing / Leasing
- Relocation Plan

Risk Mitigation HN/ML

Section III.D. – Section 221(d)(4) – NC/SR

- Cash Out from Land
- Retainage

Risk Mitigation HN/ML

Section III.D. – Section 221(d)(4) – NC/SR

- Contingency/Working Capital
- FF&E

Risk Mitigation HN/ML

Section III.D. – Section 221(d) (4) – NC/SR

- R4R
- PCNA

New Construction/Sub Rehab 221(d)(4)

- Underwriting Changes
  - Issues affecting loan sizing or project parameters

Underwriting Criterion	Old Standard	New Standard
Debt service coverage ratios	1.11	1.20
Loan-to-cost ratios	90%	83.3%
Maximum underwritten physical occupancy	93% but 95% often used	93%
Number of units	Estimated 24 month absorption	Estimated 18 month absorption

New Construction/Sub Rehab 221 (d)(4) Initial Operating Deficit

Operating deficit escrow is the greater of:

- Underwriting estimate/appraisal
- 4 months principal, interest and MIP [or 6 months]
- 3% of mortgage

New Construction/Sub Rehab 221(d)(4)

Contingency

Underwriting Criterion	Old Standard	New Standard
Sub rehab contingency	5-10%	10-15%
New construction working capital escrow	2%	4% (includes 2% contingency)

New Construction/Sub Rehab 221(d)(4) Escrow issues

Timing of Cash Out

Underwriting Criterion	Old Standard	New Standard
Release of cash-out proceeds	Not specified	No release until construction completion & sustained occupancy

FHA Multifamily
Risk Mitigation Strategy

An Example:

221 (d)(4) market rate
new construction

Sample 221(d)(4)

Units	200
Development cost	$19,930,129
Land acquisition cost	$5,000,000
Avg Rent	$1,100
Exp PUPA	$4,902
NOI	$1,556,344
Mortgage amount	$18,389,000

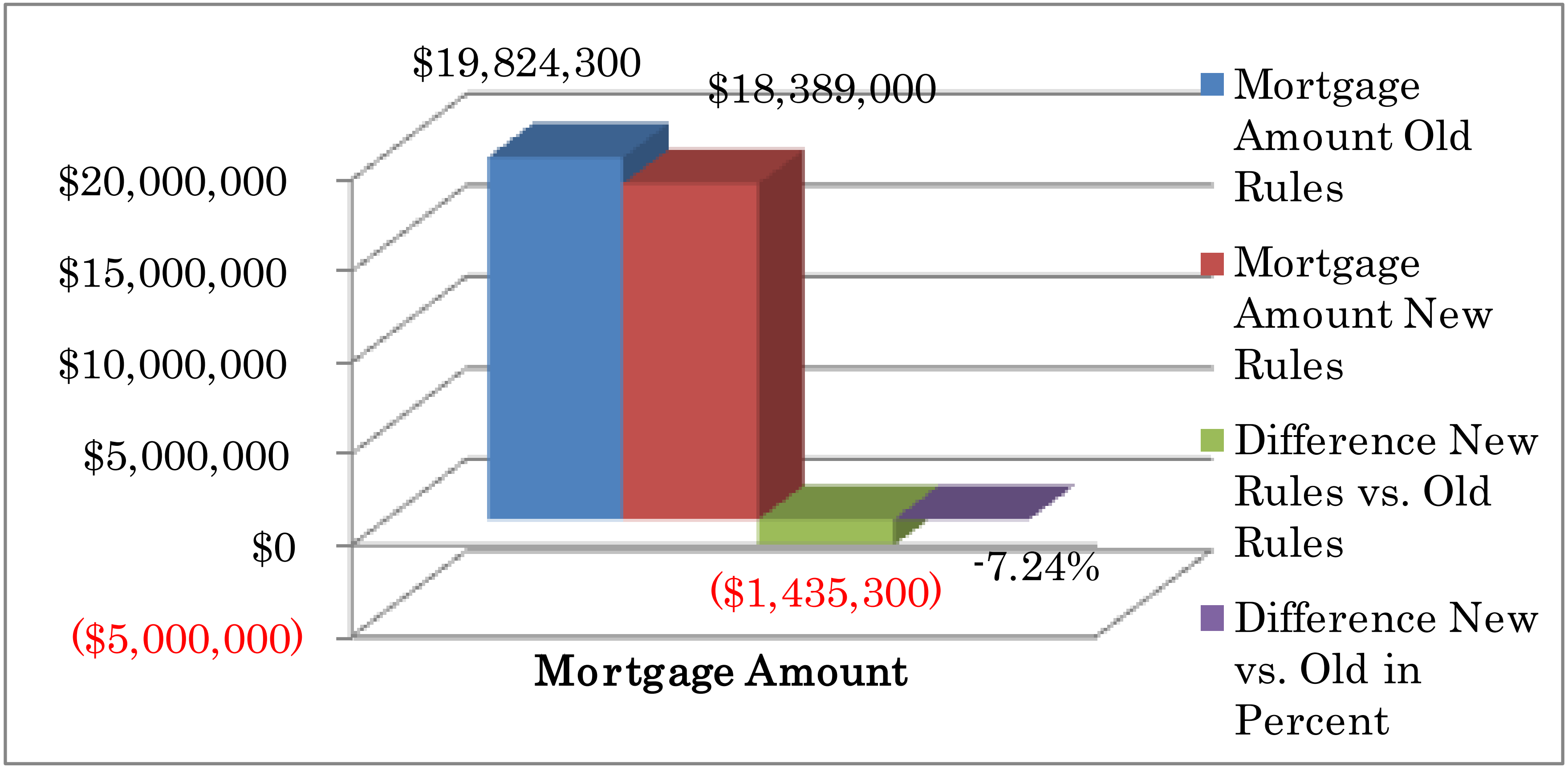
Sample 221(d)(4)

Mtg. Interest Rate	6.0000%
MIP	0.4500%
Initial curtail rate:	0.6026%
Sum of rates:	7.0526%

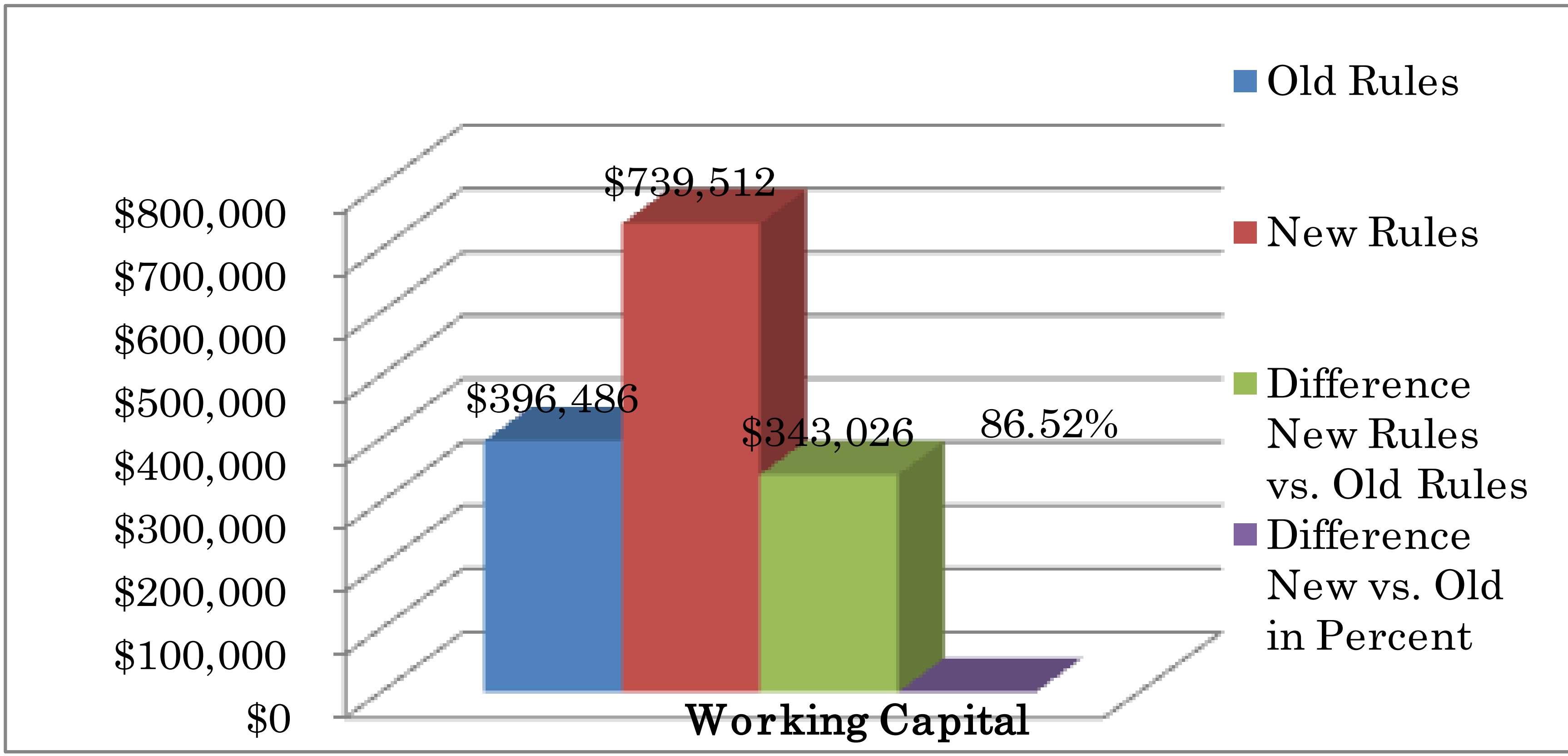
Sample 221(d)(4)

NOI	$1,556,344
DSCR required	83.33%
Available for DS	$1,296,901
rate factor	7.0526%
Debt criteria 5 unrounded	$18,389,079
Debt criteria 5 rounded down	$18,389,000

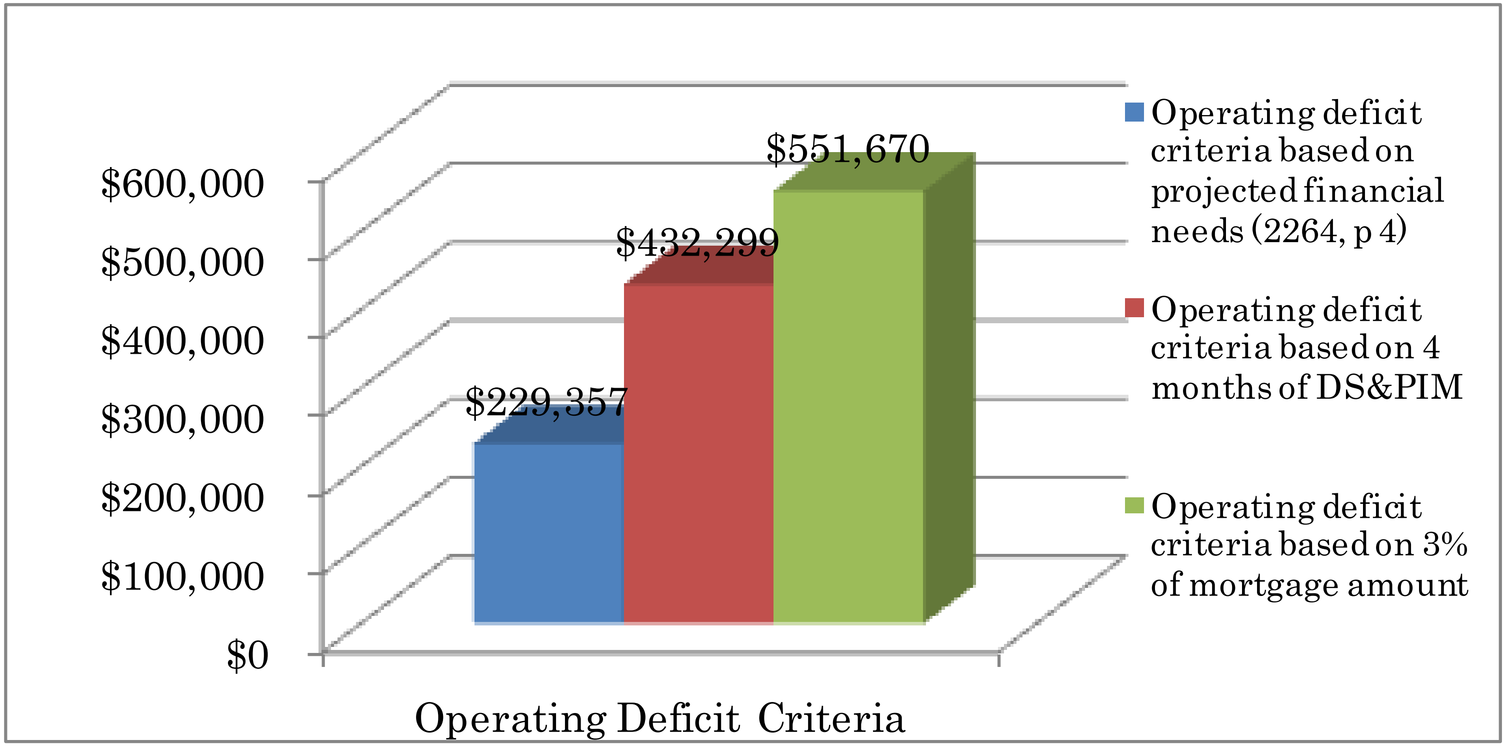
221(d)(4) - **Mortgage Amount**
Before & After



221(d)(4) - **Working Capital**
Before & After

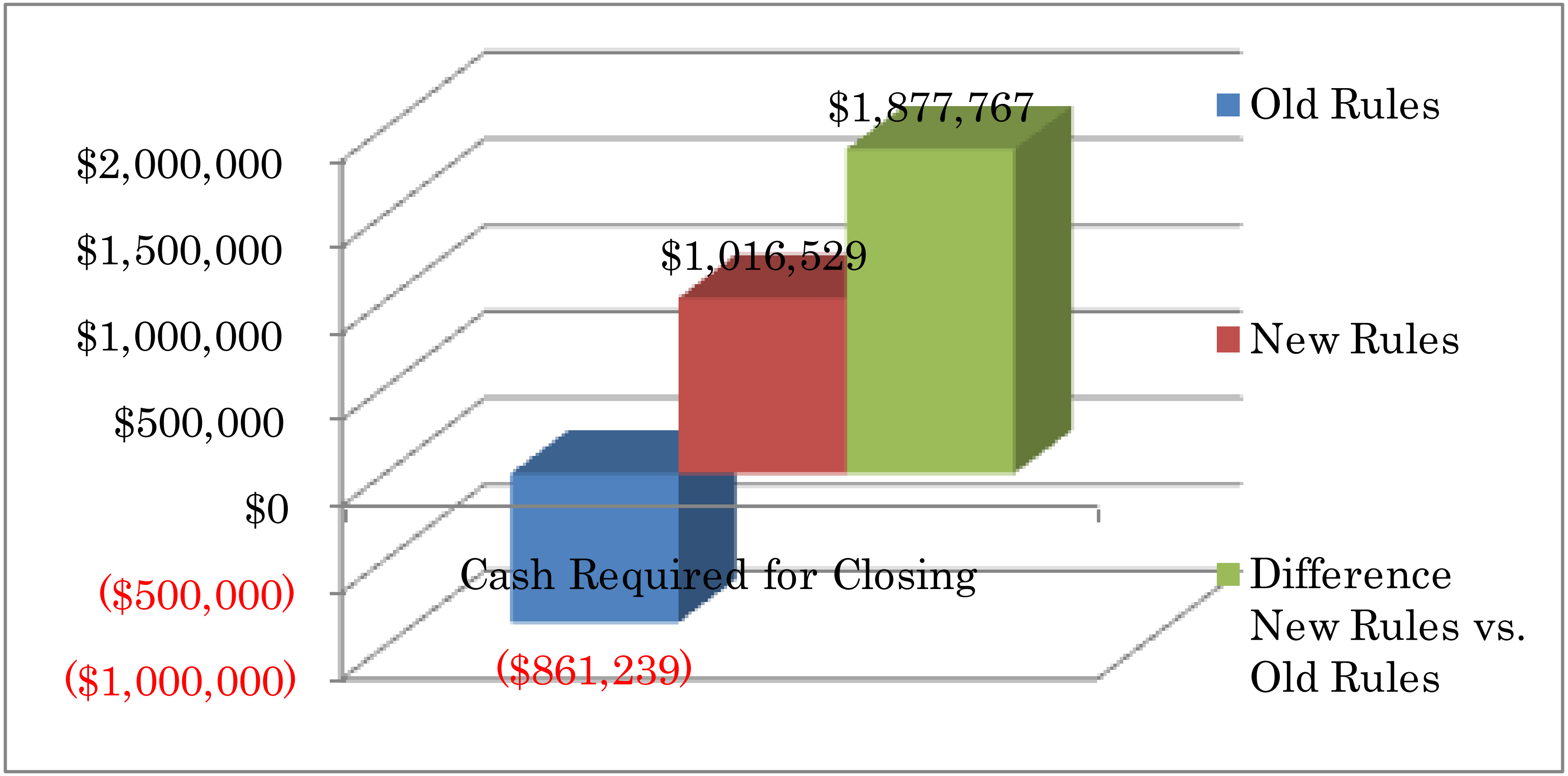


221 (d)(4) - Operating Deficit Criteria-

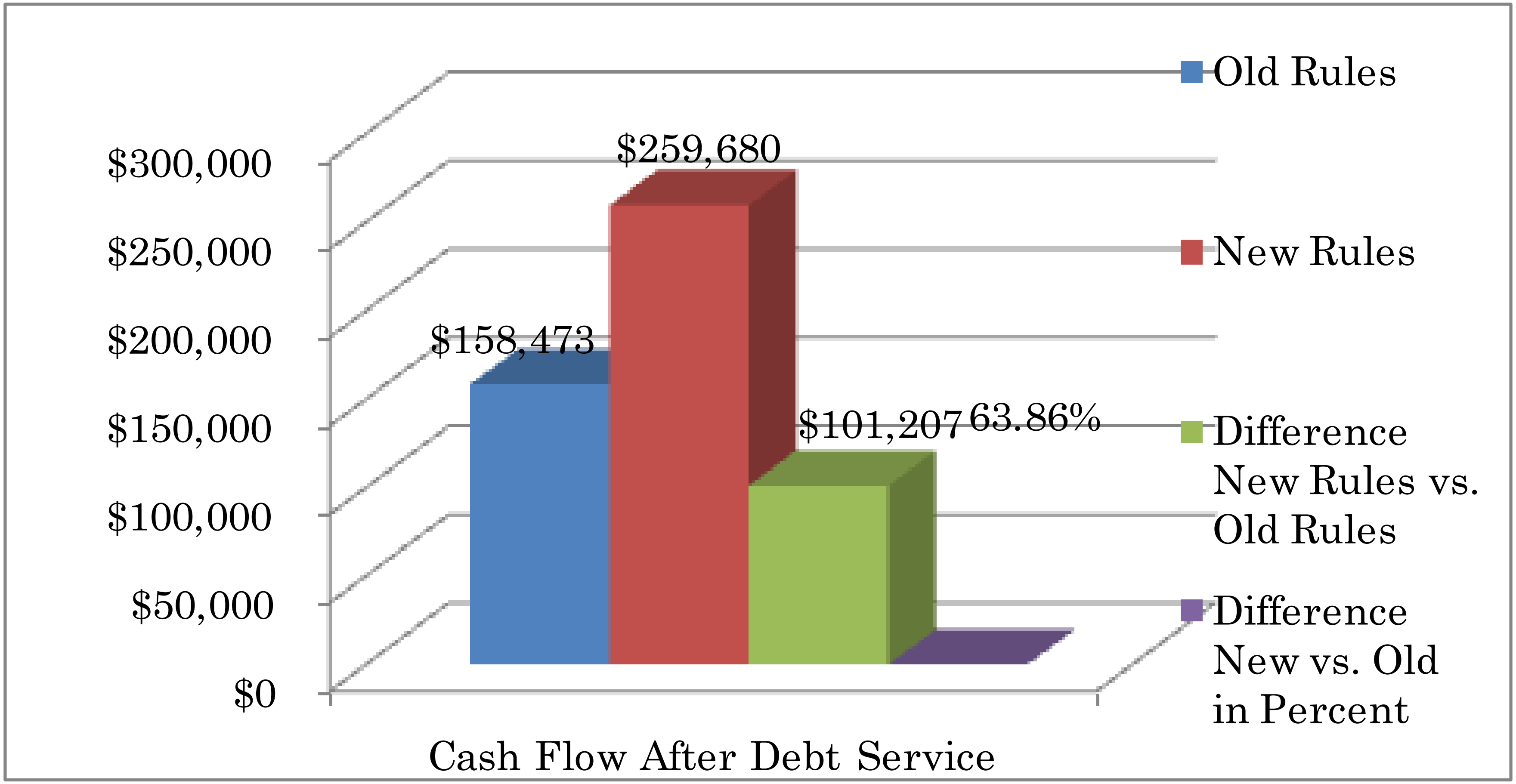


221(d)(4) - **Cash Required to Close**

Before & After



221 (d)(4) **Cash Flow** after Debt Service - Before & After



Process

- Standardized Lender Narrative
- HUD Review
- Loan Committee
- Issuance of Invite / Firm

Refinancing / Acquisition

Section 223(f)

UNDERWRITING REVIEW

223(f) Underwriting Changes – Loan Sizing Ratios

Loan to Value/Cost

Deal Type	Old	New
202 Refi	90%	90%
=>90% Rental Assistance	85%	87%
Affordable	85%	85%
Market Rate	85%	83.3%

223(f) Underwriting Changes – Loan Sizing Ratios

Debt Service Coverage

Deal Type	Old	New
202 Refi	1.11	1.11
=>90% Rental Assistance	1.176	1.15
Affordable	1.176	1.176
Market-rate	1.176	1.2

223(f) Program Changes

- Occupancy Standards
  - Physical: > 85%
  - Underwritten at <= 93%
    - Except <=95% when
      - >= 90% rental assistance, or
      - 100% of rents restricted to <80% market
  - Stable => 6 months

223(f) Program Changes

- Confirm Market & Occupancy
  - Certified Rent Roll <30 days of closing
  - Lender Onsite Inspection & Lease Audit
  - Market study in volatile/declining markets

223(f) Program Changes

- Cash Holdbacks
  - 50% of refi cash out held until repairs are completed
- Reserves
  - R4R Minimum: $250/unit
  - New PCNA & revised R4R every 10 years

223f Program Changes

- Credit Analysis
  - 3 yrs financials, last yr CPA reviewed
  - 3 yrs mortgagor tax returns
  - All expense payables cleared

Prototype 223(f) Deal

Units	144
Avg Rent	$ 890
Occupancy	92%
Exp PUPA	$ 4,711
NOI	$ 746,015
Initial R4R/Unit	$ 425
Repairs/Unit	$ 1,000

223(f): Deal Factors

Value	$9,330,000
Debt	$7,351,000
Loan Rate	5.00%
Origination Fee	1%
Placement Fee	1%

223(f) Prototype: Criteria 3
Replacement Cost/Value

Replacement Cost:		$	9,330,000
Old LtV Rule:	85%	$	7,930,500
New LtV Rule:	83.33%	$	7,774,600

223(f) Prototype: Criteria 5 Debt Service

NOI		$ 746,015	
Mtg. Interest Rate		5.00%	
MIP		0.50%	
Initial curtail rate:		1.05625%	
Sum of rates:		6.5563%	
Amount available for debt:			
Old DSCR	1.176	$ 634,113	$ 9,671,800
New DSCR	1.20	$ 621,654	$ 9,481,800

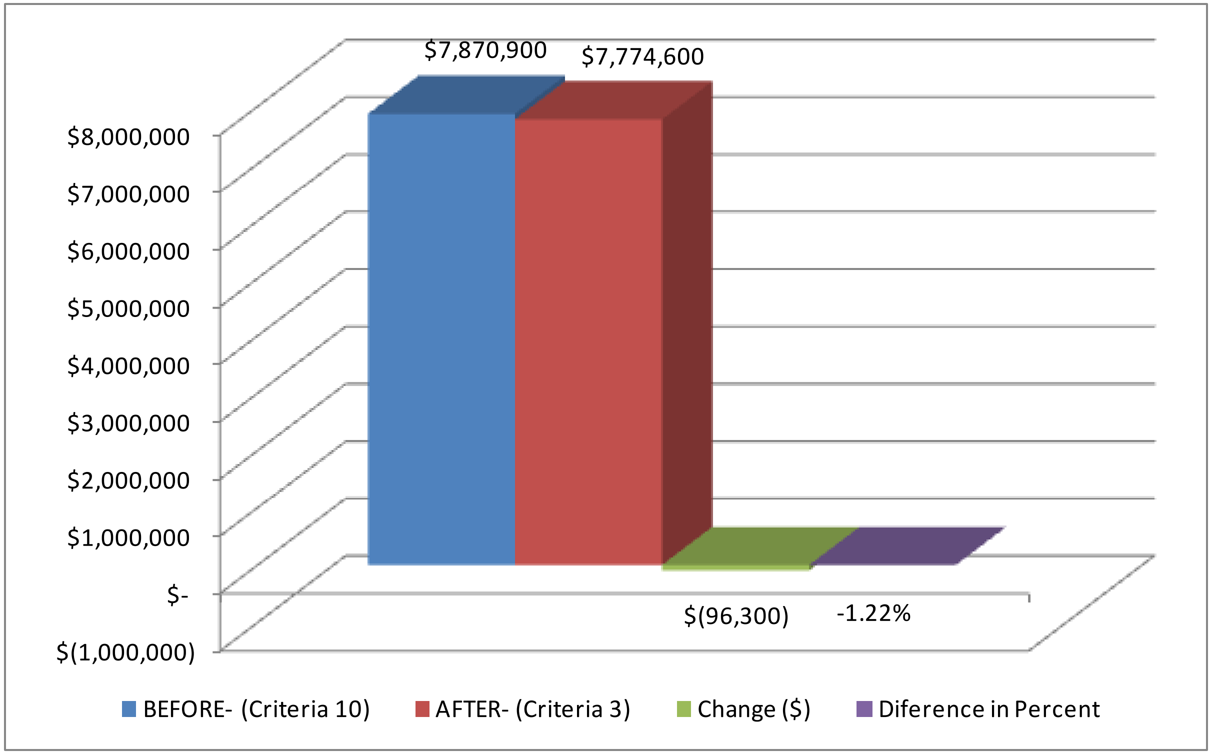
223(f) Prototype: Criteria 10
Cost of Refinancing-No Change

Existing Debt		$	7,351,000
Repairs		$	144,000
Other costs		$	15,000
Loan closing charges		$	360,940
	TOTAL	$	7,870,940
80% of Value		$	7,464,000
Criteria 10 Mortgage		$	7,870,900

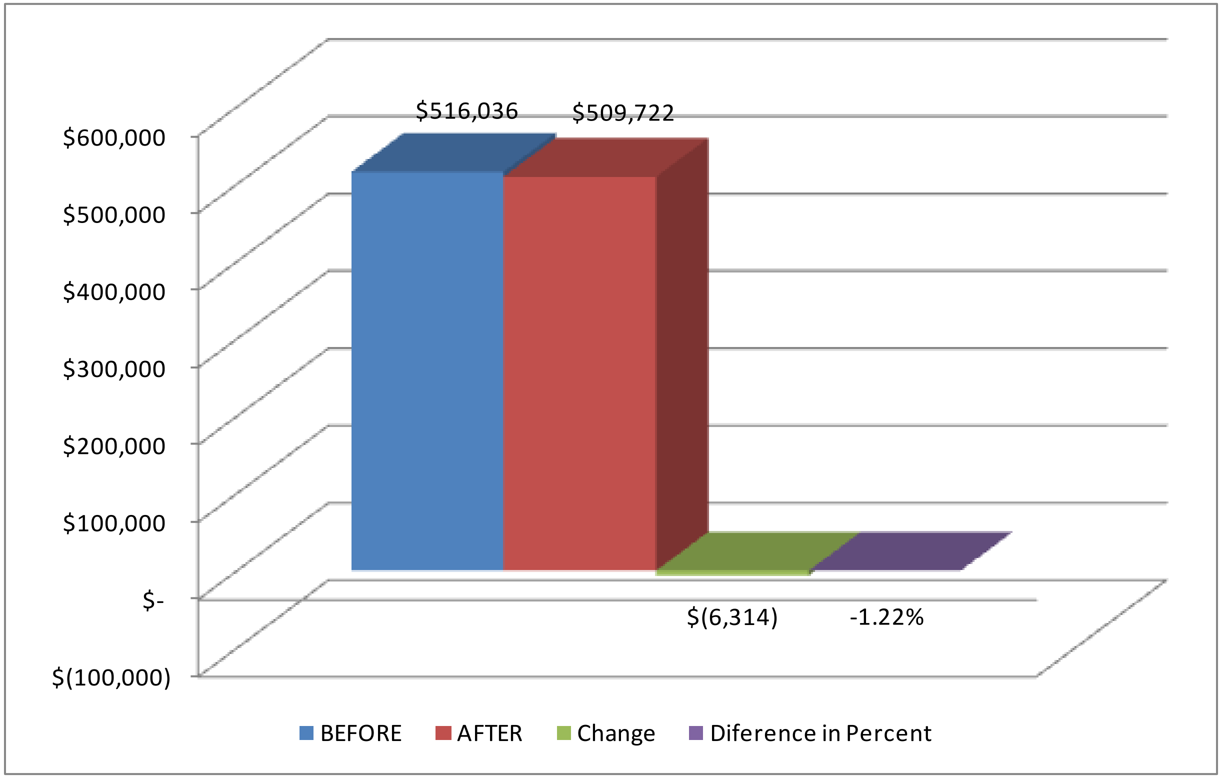
223(f) Prototype: Impact of Ratio Changes Summary

- Overall, change impacts 223(f) less than 221(d)
- Will impact marginal deals
  - If Cost of Refinance is between 83.3 – 85% LTV.

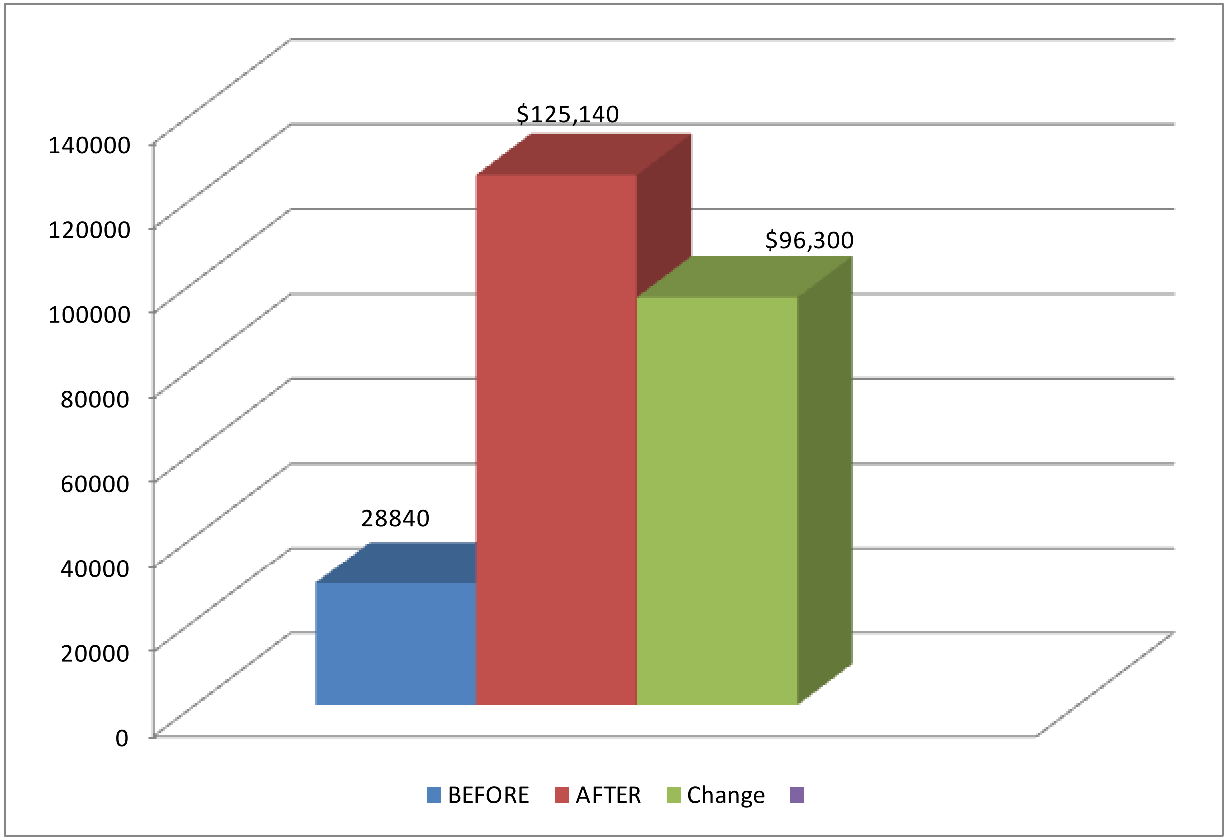
223(f) Refi: Impact of Ratio Changes Loan Size



223(f) Refi: Impact of Ratio Changes Annual Debt Service



223(f) Refi: Impact of Ratio Changes Borrower Cash @ Closing



Process

- Standardized Lender Narrative
- HUD Review
- Loan Committee
- Issuance of Invite / Firm