HUD's Office of Multifamily Production – Washington, DC

Multifamily Accelerated Processing Program

Office of Audit, Region 4
Atlanta, GA

Audit Report Number: 2016-AT-0001
May 20, 2016

To: Edward Golding, Principal Deputy Assistant Secretary for Housing, H
Priya Jayachandran, Acting Deputy Assistant Secretary, Multifamily Housing Programs, HT

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From: Nikita N. Irons, Regional Inspector General for Audit, Atlanta Region, 4AGA

Subject: HUD Did Not Enforce and Sufficiently Revise Its Underwriting Requirements for Multifamily Accelerated Processing Loans

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the Office of Multifamily Production's multifamily accelerated processing program.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG Web site. Accordingly, this report will be posted at http://www.hudoig.gov.

If you have any questions or comments about this report, please do not hesitate to call me at 404-331-3369.

Audit Report Number: 2016-AT-0001
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HUD Did Not Enforce and Sufficiently Revise Its Underwriting Requirements for Multifamily Accelerated Processing Loans

Highlights

What We Audited and Why

We audited the U.S. Department of Housing and Urban Development's (HUD) multifamily accelerated processing (MAP) program administered by its Office of Multifamily Production. We initiated the audit under our annual audit plan. Our objectives were to determine whether (1) HUD adequately reviewed and approved loans underwritten by MAP-approved lenders for Federal Housing Administration (FHA) insurance and (2) the 2016 MAP Guide was adequately revised to improve the review and approval process for MAP loans.

What We Found

HUD did not adequately review and approve nine[1] loans underwritten by MAP-approved lenders for FHA insurance. Specifically, HUD did not require lenders to adequately address a number of underwriting components. As a result, HUD inappropriately approved nine loans submitted by six MAP lenders, which exposed the FHA insurance fund to unnecessary risk.

In addition, the 2016 MAP Guide was not sufficiently revised and could be further improved and modified to correct inconsistencies with certain underwriting components and the overall review and approval process. By missing these underwriting components, HUD may have missed the opportunity to develop a stronger MAP Guide to reduce risk exposure.

What We Recommend

We recommend that the Principal Deputy Assistant Secretary for Housing require the Office of Multifamily Housing Programs to revise its memorandum of understanding to ensure that loans are reviewed for compliance with MAP underwriting requirements. In addition, we recommend that the Acting Deputy Assistant Secretary for Multifamily Housing Programs require the Office of Multifamily Production to (1) issue alternate guidance to update and clarify inconsistencies in the 2016 MAP Guide and (2) formalize a training program to ensure that new staff members are familiar with the Single Underwriter model.

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[1] According to the Office of Multifamily Production, between 2002 and 2010, more than 8,600 loans were underwritten and closed by MAP-approved lenders. We reviewed nine of the loans that had strong indicators of problems and found underwriting deficiencies in all nine loans. See the Background and Objectives section of this audit report for a listing of the nine loans.

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Background and Objectives

Since 1937, Federal Housing Administration (FHA) multifamily mortgage insurance has been a major source of financing for affordable housing. FHA mortgage insurance protects lenders against losses from defaults. HUD's Office of Housing is responsible for establishing requirements for the administration of HUD's multifamily mortgage insurance program, primarily through its Office of Multifamily Housing Programs (Multifamily). Within Multifamily, the Office of Multifamily Production is responsible for originating FHA mortgage insurance loans and implementing the multifamily accelerated processing (MAP) program. The MAP program is designed to establish national standards under which approved lenders may prepare, process, and submit loan applications for FHA multifamily mortgage insurance. In accordance with MAP guidelines, the sponsor works with the MAP-approved lender, which submits required exhibits for the preapplication stage. After HUD reviews the exhibits, it either invites the lender to apply for a firm commitment for mortgage insurance or declines the application. For acceptable exhibits, the lender submits the firm commitment application, including a full underwriting package, to HUD to determine whether the loan is an acceptable risk. Further, the MAP team leader must decide to approve, reject, or require modification of the application based upon the recommendation of technical specialists.

Following the 2008 financial crisis, Multifamily experienced an unprecedented demand for services. Between 2008 and 2013, Multifamily experienced an increase in originations from $3 billion nationally to almost $18 billion. The complexity of the work also increased. In response, HUD initiated the Multifamily for Tomorrow transformation, consisting of four components: (1) National Workload Sharing,[2] (2) the Single Underwriter Model in the Office of Multifamily Production,[3] (3) the Account Executive Model in the Office of Asset Management,[4] and (4) streamlining the organizational structure.[5]

During the implementation of the transformation, HUD also began to revise its 2016 MAP Guide. Before finalizing the MAP Guide in January 2016, HUD issued notices and memorandums implementing some of the changes in the program. For example, the Single Underwriter Model discussed above was introduced in a memorandum, dated January 30, 2015. The MAP Guide was originally published in May 2000 and revised in March 2002 (2002 MAP Guide) and November 2011 (2011 MAP Guide).

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[2] Multifamily Production and Asset Management workload was electronically digitized and distributed evenly to ensure consistency.
[3] This system segments applications by risk and complexity for assignment to the appropriate underwriter. An underwriter will manage the end-to-end review of an application and draw in technical specialists as needed.
[4] In this system, account executives manage nontroubled assets; senior account executives manage complex and troubled assets; and asset resolution specialists manage the most complex, risky, or troubled assets.
[5] Multifamily consolidated its 17 hubs into five new regions and established four new offices in headquarters.

From June 21, 2004, to August 14, 2015, we issued eight external audit reports, which concluded that six MAP lenders did not underwrite and process nine loans in accordance with HUD's requirements. These eight external reports identified more than $110 million in questioned costs and funds put to better use. The loans for each project listed in the table below were underwritten using the 2002 MAP Guide, published on March 15, 2002.

Audit report	Project name	Lender	HUD office	Questioned cost - funds put to better use
2004-SE-1005	Hudson Valley and Amber Courts	Continental Securities	Buffalo, NY	$13,268,851
2007-FW-1011	Asbury Square	Capmark Finance	Ft. Worth, TX	5,934,112
2009-FW-1010	Cypress Ridge	Harry Mortgage	Oklahoma City, OK	3,759,333
2011-PH-1009	Wingate Towers & Garden Apartments	Deutsche Bank	Baltimore, MD	29,774,713
2014-AT-1015	Preserve at Alafia	Prudential Huntoon Paige & Assoc. (Prudential)	Jacksonville, FL	20,157,329
2015-AT-1003	Amaranth at 544	Prudential	Ft. Worth, TX	10,159,961
2015-KC-1005	Temtor	Berkadia Commercial Mortgage	Kansas City, MO	11,312,956
2015-AT-1007	Lafayette Towers	Prudential	Detroit, MI	15,727,529
Total				**$110,094,784**

As of September 2015, the program's default percentage of unpaid principal balance[6] had decreased to 0.15 from a default rate of 1.65 percent in September 2010. Of the loans underwritten using the 2011 MAP Guide, no loans had gone into early claim.[7] HUD attributed the default rate reduction to market factors, improved underwriting, and an increase in loss mitigation strategies.

Our objectives were to determine whether (1) HUD adequately reviewed and approved loans underwritten by MAP-approved lenders for FHA insurance and (2) the 2016 MAP Guide was adequately revised to improve the review and approval process for MAP loans.

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[6] The defaulted unpaid principal balance as of September 2015 was $109 million for 10 loans, while the active loans totaled 10,760. As of September 2010, the defaulted unpaid principal balance totaled $723 million for 87 loans when the active loans totaled 9,807.

[7] HUD defines an early claim as a claim filed within 4 years of final endorsement.

Results of Audit

Finding 1: HUD Did Not Adequately Review and Approve MAP Loans

HUD did not adequately review and approve nine loans underwritten by MAP-approved lenders. Specifically, it did not require lenders to adequately address a number of key components in the underwriting process before approving MAP loans. The loans contained multiple deficiencies, which affected the insurability of the loans. HUD failed to enforce and comply with MAP underwriting requirements. In addition, it did not maintain an adequate monitoring system of approved loans for compliance with MAP requirements. As a result, HUD inappropriately approved nine loans submitted by six MAP lenders, which exposed the FHA insurance fund to unnecessary risk. The nine loans contained significant underwriting deficiencies as summarized in table 1.

Table 1: List of loan deficiencies

Deficiency	Number of occurrences	Multifamily hub
Inadequate review of principals and contractors	7	Detroit, MI, Jacksonville, FL, Ft. Worth, TX, Kansas City, MO, Oklahoma City, OK, Baltimore, MD, and Buffalo, NY
Inadequate review of appraisal	3	Detroit, MI, Jacksonville, FL, and Ft. Worth, TX
Inadequate review of project revenue	3	Jacksonville, FL, Ft. Worth, TX, and Kansas City, MO
Inadequate review of market studies	2	Jacksonville, FL, and Ft. Worth, TX
Inadequate review of project financial background	2	Detroit, MI, and Ft. Worth, TX
Failure to ensure that critical repairs were completed before closing	1	Detroit, MI
Inadequate review of project repair cost and scope of work	1	Baltimore, MD
Improper consideration of technical staff conclusions	1	Ft. Worth, TX
Inadequate assessment of prepaid cost	1	Jacksonville, FL
Failure to follow MAP timelines for site inspections	1	Ft. Worth, TX
Failure to enforce FHA guidelines for loan limits	1	Buffalo, NY

We reviewed all eight external audit reports[8] issued between 2004 and 2015 that were conducted to determine whether individual MAP-approved lenders underwrote and processed the loans on nine[9] projects according to MAP requirements. We reviewed these audit reports to determine whether HUD adequately reviewed and approved the loans submitted by the MAP-approved lenders for FHA insurance.

Under HUD's MAP program, approved lenders prepare, process, review, and submit loan applications for multifamily mortgage insurance. Regarding HUD's role, the 2002 MAP Guide, paragraph 11.2.F, provides that each HUD technical specialist, by discipline, reviews the respective lender's reviewers' reports, the underwriting summary, and certain key elements of the application specified in the MAP Guide. The HUD technical specialist reviews the quality of the lender's review and the transaction itself. The HUD technical specialist does not reprocess the case. However, if the technical specialist determines that certain underwriting conclusions were not supportable and affect HUD's risk, the specialist recommends the modification of the firm commitment application, recommend that the lender modify the application, or recommend a rejection. Whether the application is modified internally or by the lender may depend upon the scale or severity of the issue, timing, etc. The team leader must decide to approve, reject, or require modification of the application based upon the recommendation of the specialist.

Based on our review, for the following deficiencies, HUD should have determined that the lenders' underwriting conclusions were not supportable, which should have resulted in HUD's recommending (1) modification of the firm commitment application or (2) a rejection of the loan application.

Inadequate Review of Principals and Contractors

HUD did not ensure that the lenders adequately assessed the eligibility and background of principals and participants in seven of the projects. Table 2 describes the deficiencies noted during our review.

Table 2: List of principals' and contractors' review deficiencies

Project name	Our determination
Alafia	HUD did not (1) require the lender (Prudential) to mitigate the risk associated with the principal's lack of experience in HUD programs, (2) assess the borrower's financial capacity, and (3) question the lender's allowing the broker to also act as a trustee for a $1 million loan to the borrower.[10]
Amaranth	HUD did not require the lender (Prudential) to provide documentation to adequately

[8] The reports reviewed are listed in the Background and Objectives section of this audit report.

[9] Seven of the eight audit reports included a review of one project's underwriting in each report; however, one of the eight audit reports included a review of the underwriting of two projects. See the Background and Objectives section of this audit report for details.

[10] 2002 MAP Guide, paragraphs 8.3.J, 8.3A.4, 8.4.A.1.2, 8.3.F, 8.16, and 3.2.K

Project name	Our determination
	support the borrower's financial capacity. Specifically, the borrower's net worth calculation included $6.9 million in real property. However, HUD did not require the lender to provide support for the property.[11]
Temtor	HUD did not require the lender (Berkadia) to mitigate the risk associated with the principal's lack of experience in HUD programs.[12]
Lafayette	HUD did not require the lender (Prudential) to (1) adequately outline the borrower's experience in HUD programs and (2) assess the eligibility of two principals not listed on the underwriter narrative but listed in the borrower's support documentation.[13]
Wingate	HUD did not require the lender (Deutsche) to (1) perform a full credit investigation of the sponsor and the principals of the project and (2) obtain complete financial statements from the general contractor to accurately determine its working capital.[14]
Amber	HUD did not require the lender (Continental) to make a valid determination of the construction contractor's capacity. Specifically, the contractor's working capital inappropriately included significant loans due from officers and affiliates as current assets. However, HUD did not identify the issue and require the lender to recalculate the figure.[15]
Cypress	HUD did not require the lender (Harry) to (1) obtain complete financial statements from the general contractors to accurately determine its working capital and (2) affirm the general contractor's construction capacity in terms of the type and size of previous projects.[16]

The following is an example of HUD's inadequate review of principals and contractors.

- HUD did not require Prudential to adequately assess the background and eligibility of the borrower and its principals before approving them for the FHA mortgage for Lafayette. HUD did not assess the eligibility of two principals that were not listed in the underwriter narrative. The underwriter narrative listed one sole principal in the borrower's mortgage development team. However, HUD's files included the borrower's limited liability corporation documentation, which revealed that the borrower had two additional principals.

[11] At the time of underwriting for Amaranth, the 2002 MAP Guide did not require support for real property. Instead, it required only that the lender practice due diligence and prudent underwriting practices as defined in the MAP Guide, paragraphs 11.1.C and 15.3.A.6. During HUD's review of the mortgage credit, however, it considered whether the lender carried out its due diligence. HUD has since identified this weakness, updated the criteria, and developed requirements in paragraph 8.4.A.5 of the 2011 MAP Guide to require that the principals provide real estate-owned and mortgage debt schedules to support asset values reported on their financial statements.

[12] 2002 MAP Guide, paragraph 8.3. J

[13] See criteria cited in footnote 10.

[14] 2002 MAP Guide, paragraphs 8.3.E.3, 8.3.H, 8.4.A.2, and 8.4.C.12.d

[15] 2002 MAP Guide, paragraph 8.4.C.3

[16] 2002 MAP Guide, paragraphs 8.4.C.12.d and 8.4.C.3

HUD should have identified the additional principals. HUD's failure to identify and require an assessment of the additional principals was significant because one of the principals had financial issues, including outstanding liens totaling $2.2 million filed by contractors, civil suits, mortgage defaults, and foreclosures. HUD's failure to enforce its requirements resulted in the approval of a borrower that contributed to the project's default.

Due to HUD's failure to enforce its eligibility requirements for the project principals and contractors, five lenders inappropriately approved multiple principals and contractors that may not have had the capacity to complete and operate the projects.

Inadequate Review of Appraisals

HUD did not adequately review the appraisals for three of the projects. Many of the deficiencies identified in the projects' appraisals were recurring issues. Table 3 describes these deficiencies.

Table 3: List of appraisal review deficiencies

Project name	Our determination
Alafia	HUD (1) allowed the lender (Prudential) to use an inappropriate comparable, (2) did not require the lender to provide adequate support for adjustments, and (3) did not require the lender to identify the actual location of the vacant land site.[17]
Amaranth	HUD did not question the lender's (Prudential) (1) inappropriate adjustments, (2) inclusion of inappropriate outliers, and (3) inclusion of a property with incomparable zoning.[18]
Lafayette	HUD (1) allowed the lender (Prudential) to use an inappropriate comparable, (2) did not question the lender's failure to use the previous sale of the subject property as a comparable, (3) did not question the lender's inappropriate comparable adjustments, (4) did not question the lender's unreasonable project expense estimate, and (5) did not question the lender's unsupported capitalization rates.[19]

The following is an example of HUD's inadequate review of appraisals.

- HUD did not require that Prudential adequately support the value of the property for Lafayette. The lender overstated the property value by more than $11 million. The subject property previously sold for $16 million, and the appraiser valued the property at $28.6 million less than 1 year later with only $1.4 million in repairs. Based on information also available at the time of the lender's appraiser review, we recalculated the value to be $17.5 million, more than $11 million less than Prudential's appraised value. The improper $28.6 million appraised value was used to support the $22.8 million mortgage amount. HUD should have identified and required the lender to address the (1) inappropriate comparable

[17] 2002 MAP Guide, paragraphs 7.10.C.2 and 7.4.A.3
[18] 2002 MAP Guide, paragraphs 7.10.C.2, 7.4.A.3, and 7.4.A.4
[19] 2002 MAP Guide, paragraphs 7.11.C.2, 7.4.A.3, and 7.4.A.4

sales, (2) inappropriate market data adjustments, (3) unreasonable operating expenses, and (4) unsupported capitalization rates. In addition, HUD should have rejected the application or required the lender to modify the loan application.

Due to HUD's failure to enforce MAP appraisal and Uniform Standards of Professional Appraisal Practice (USPAP) requirements, the lender's appraisers overstated three projects' combined land value by more than $15 million.[20]

Inadequate Review of Project Revenue

HUD did not adequately assess project revenue for three of the subject projects.[21] Table 4 describes the deficiencies noted.

Table 4: List of project revenue review deficiencies

Project name	Our determination
Alafia	HUD inappropriately approved the unsupported estimate of revenue[22] proposed by the lender (Prudential). The lender overstated the project revenue estimated for the project because it failed to use available up-to-date market data and relied on optimistic indicators, which was a violation of HUD requirements.
Amaranth	HUD inappropriately approved the unsupported estimate of revenue[23] proposed by the lender (Prudential), although HUD was aware that the proposed rents might need to be lowered to be more competitive. The lender overstated the revenue that the project could achieve, which affected the project's ability to meet its obligations.
Temtor	HUD inappropriately allowed the lender (Berkadia) to include (1) commercial rent[24] in projected revenue without establishing the market rent and (2) uncertain tax increment financing in its projected income estimate.

Due to the lack of tax increment financing revenue guidance[25] (Temtor) and HUD's failure to enforce revenue requirements (Alafia and Amaranth), the lenders overstated the achievable revenue, which in turn affected the project's ability to meet its financial obligations.

Inadequate Review of Market Studies

HUD did not adequately review the market studies for the Alafia and Amaranth projects.[26] Specifically, HUD did not identify and require the lender to resolve the timeliness issues in the

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[20] The lender's appraisal overstated the land value by $4 million, $300,000, and $11 million for Alafia, Amaranth, and Lafayette, respectively.
[21] 2002 MAP Guide, paragraphs 7.6.A, 7.6.B, and 7.6.F
[22] 2002 MAP Guide, paragraphs 7.6.A and 7.6.B
[23] 2002 MAP Guide, paragraph 7.6.B
[24] 2002 MAP Guide, paragraph 7.6.F
[25] The 2016 MAP Guide now includes language regarding how lenders should address tax increment financing income.
[26] 2002 MAP Guide, paragraphs 7.5.B and 7.5.E

Alafia market study. The Alafia market study included outdated statistics, such as unemployment rates, census data, trend analysis for employment, and building permits, that were dated from January 2000 to May 2007, about 15 months before the effective date of the July 2008 market study report.

In addition, HUD did not require the lender to adequately support the market need for Amaranth. HUD should have required the lender to ensure that the market analysis included verifiable information. HUD's failure to enforce this requirement also affected the project's feasibility. The market study stated that Amaranth was superior to other properties in the market and, thus, warranted higher rents. However, we reviewed the comparable property data and determined that other properties offered the same or similar amenities and in some instances, were located in superior areas.

Due to HUD's failure to enforce its market study requirements, the lender underwrote the loans with inadequate and untimely information for Amaranth and Alafia, respectively, which did not conservatively present the market conditions affecting the projects' feasibility.

Inadequate Review of Project Financial Background

HUD did not ensure that the financial history of Lafayette and Asbury was adequately reviewed. Specifically,

- Lafayette - HUD did not require Prudential to provide all of the required financial statements on the property for the previous 3 years. The MAP Guide required the borrowers to submit the last 3 fiscal years' financial statements for projects,[27] but there may be conditions beyond the borrower's control under which the financial information cannot be obtained. In those instances, the borrower must submit evidence, satisfactory to the lender, that the financial statements were not obtainable. The lender must submit to HUD (1) a written statement by the borrower explaining why the records were not obtainable and (2) a memorandum from the lender stating that it evaluated the statement and agreed that the information was unobtainable. However, HUD did not ensure that the lender provided such documentation. Specifically, HUD's records included notes about the financial position of the project, which stated that the financial information provided in the application was limited and not thorough. Since HUD did not enforce this requirement, it was also unable to completely assess the property's financial position. Due to HUD's failure to enforce the requirements for financial background, the lenders did not obtain complete financial data needed to assess the project's financial position to make sound economic decisions regarding mortgage approval for insurance.

- Asbury - HUD did not question the negative working capital as an issue to be addressed by the lender. The lender attached the mortgage credit analysis worksheet for the owner of Asbury to the underwriting narrative submitted with the firm application. The mortgage

[27] 2002 MAP Guide, paragraph 8.4.B.3

credit analysis worksheet showed that the project had a $1.1 million negative working capital balance. In addition, HUD's review did not identify that the aged accounts payable schedule had not been obtained and reviewed by the lender in accordance with MAP requirements.[28] Due to HUD's failure to enforce the requirements, it did not ensure that all of the financial information in the application was consistent and supported sound economic decisions regarding mortgage approval.

Failure To Ensure That Critical Repairs Were Completed Before Closing

HUD did not ensure that the critical repairs[29] at Lafayette were completed before the loan's closing. Lafayette's project capital needs assessment showed that the project's critical repairs totaled more than $99,000. The assessment included repair items related to asbestos, electrical hazards, and fire safety. The 2002 MAP Guide[30] required critical repairs to be completed before closing due to safety and security hazards. However, 8 of the 10 repairs were not completed. In addition, a HUD construction specialist explained that in some instances, the Detroit, MI, Multifamily hub had a general practice of allowing critical repairs to be completed within 3 or 4 months after closing. Due to HUD's failure to enforce the critical repair requirements, the lender obtained loan approval for a project that had incomplete repairs, including health and safety issues.

Inadequate Review of Project Repair Cost and Scope of Work

HUD did not adequately review the architectural and engineering cost report and the scope of work for Wingate's repairs.[31] The cost report noted that the conditions for firm commitment included that asbestos would be removed as part of the proposed work but did not include an amount. The cost report also included a cost comparison worksheet based on figures submitted by the general contractor. However, the cost comparison worksheet did not mention asbestos removal and did not provide a cost estimate for asbestos removal. The scope of work also did not include all of the repairs needed to bring the property to a marketable condition. Further, during construction, the general contractor filed a demand for arbitration for additional costs of $680,000 for the removal of asbestos, which was not included in the original scope of work. Due to HUD's failure to enforce its substantial rehabilitation requirements,[32] the lender underestimated the project's construction costs.

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[28] 2002 MAP Guide, paragraphs 8.4.B.2.d.1 and 8.4.B.2.d.2

[29] Critical repairs are any individual or combination of repairs required to correct conditions that (1) endanger the safety or well-being of residents, patients, visitors or passers-by; (2) endanger the physical security of the property; (3) adversely affect project or unit(s) ingress or egress; and (4) prevent the project from reaching sustaining occupancy.

[30] 2002 MAP Guide, paragraphs 5.25.A and 5.25.B

[31] 2002 MAP Guide, paragraph 6.6.B.1.b.1

[32] 2002 MAP Guide, paragraph 6.6.B.1.b.1 required the lenders to provide cost estimation specific to substantial rehabilitation including asbestos removal. In addition, the lender's cost estimator is also required to prepare a detailed cost estimate including quantities and unit costs for all items.

Improper Consideration of Technical Staff Conclusions

HUD's management did not always fully consider pertinent information identified by its technical staff. Specifically, the borrower for Amaranth should have provided a higher level of funding for its initial operating reserves. The lender (Prudential) calculated an operating deficit of $482,507;[33] however, the HUD technical specialist recommended a debt service of more than $800,000. Although HUD's program manager reviewed the technical specialist's comments, the specialist's recommendations were disregarded, and the program manager allowed the borrower to obtain a firm commitment without requiring a higher operating deficit. In addition, HUD management did not fully consider the appraisal concerns identified by its technical staff. The lender's appraiser valued the land at more than $1.6 million, while HUD's appraiser valued the land at less than $1.3 million, a difference of more than $345,000. HUD's program manager reviewed the HUD appraiser's analysis but did not mention the appraiser's reduction in the lender's land valuation in the firm issuance request. Due to HUD's improper consideration of its technical staff's input, the lender overstated the project's land value and failed to require a higher deficit reserve, which contributed to the project's failure in meeting its debt service.

Inadequate Assessment of Project Prepaid Costs

HUD inappropriately allowed the lender to include prepaid costs[34] not related to the project for the Alafia project.[35] The borrower intended to develop the property into a mixed-use development, including commercial use, retail use, and apartments; however, only the costs related to the apartments should have been included as eligible prepaid costs in accordance with HUD's requirements. The project's inappropriate prepaid costs included commercial development for a full service hotel, travel expenses for lodging and airfare to conventions, meals, and security devices for the owners' businesses not located at the subject site. HUD should have questioned the ineligible costs before endorsing the mortgage. Due to HUD's failure to enforce its prepaid cost requirements, the lender included inappropriate expenses in the mortgage amount.

Failure To Follow MAP Timelines for Site Inspections

HUD inappropriately approved the lender's firm application for Asbury without requiring it to participate in a thorough joint inspection with HUD and the lender's architect. The followup joint inspection was required to determine the type and the extent of the work that would make the project viable. The property's initial site inspection was completed by the lender more than 7 months before HUD issued the invitation letter indicating preapplication approval and more than 14 months before HUD received the firm application. As a result, the owner's architectural drawings and specifications did not address all of the property's rehabilitation needs. In accordance with the MAP Guide,[36] an additional site inspection was required to provide any

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[33] A HUD Office of Inspector General (OIG) appraiser calculated the operating deficit at $958,636 for a difference of $476,129.

[34] Prepaid costs are future expenses that have been paid in advance. The total prepaid costs were included in the mortgage amount.

[35] National Housing Act (12 U.S.C. (United States Code) 17151(d)(4)) Section 221

[36] 2002 MAP Guide, paragraph 5.14

necessary additional conditions for firm commitment. HUD should have noted that the inspection was completed several months earlier and required an additional site inspection before issuing the invitation for the firm commitment. If HUD had required the additional inspection, it may have learned that both the contractor and the owner's architect had informed the lender that the scope of work did not include many of the vital repairs needed by the project. Due to HUD's failure to enforce the timelines requirements for site inspections, the lender's scope of work did not include repairs for 87 uninhabitable units, which contributed to a maximum occupancy rate being significantly less than the proposed occupancy rate needed to pay expenses and debt service.

Failure To Enforce FHA Guidelines for Loan Limits

HUD inappropriately allowed the lender to underwrite a loan with an amount exceeding FHA financing limits. According to the MAP Guide,[37] secondary financing is limited to the difference between the HUD-insured mortgage and the HUD fair market value of the property. However, the Hudson purchase transaction included the financing instruments shown in table 5.

Table 5: FHA limit calculation

Financial instrument	Amount
Secured Series "A" bond (secured by FHA mortgage)	$18,900,00
Unsecured Series "B" bond (unsecured secondary bonds)	4,245,000
Other – undetermined[38] (secondary note)	485,000
Total	$23,630,000
Fair market value	(21,000,000)
Amount over FHA limit	$2,630,000

The Hudson transaction included financing totaling more than $23.6 million, and the HUD fair market value of the property was $21 million. The finance transaction included $18.9 million in Series A bonds secured by the FHA mortgage, more than $4.2 million in unsecured Series B secondary bonds, and $485,000 for a subordinate secondary note. Due to HUD's failure to enforce FHA loan limit requirements, it allowed the lender to include inappropriate secondary financing, which caused the loan to exceed financing limits by more than $2 million and thereby exposed the FHA fund to additional unreasonable or unnecessary risk.

Lack of Adequate Monitoring System

The Office of Multifamily Housing Programs did not ensure that compliance reviews were conducted for the MAP program. According to HUD's Departmental Management Control Program handbook,[39] management control is an ongoing process requiring managers to evaluate

[37] 2002 MAP Guide, paragraph 8.10.B

[38] The bond documents for the $4.2 million amount referred to a subordinate secondary note totaling $485,000, but the lender claimed that at least part of the amount was a part of the $4.2 million. However, the lender was unable to provide documentation to support its position.

[39] HUD Handbook 1840.1, REV-3, Policy

their programs and establish appropriate controls to ensure that HUD programs and activities are efficiently and effectively managed; protect against fraud, waste, and abuse; and follow applicable laws and regulations. Further, it states that HUD will maximize its use of available resources by incorporating risk management concepts and strategies in the conduct of all programs and activities. In addition, Office of Management and Budget Circular A-123, section IV, requires managers to continuously monitor and assess the effectiveness of management controls for their programs.

On February 6, 2012, Multifamily[40] and HUD's Office of Risk Management and Assessment (ORMA) entered into a memorandum of understanding, which outlined that ORMA would perform five post commitment loan reviews per month. The memorandum provided that the loan reviews were intended to evaluate the quality of multifamily underwriting and ensure that the underwriter complied with the MAP Guide. However, the loan reviews conducted by ORMA did not include a compliance component and did not state whether HUD underwriters complied with MAP requirements. Instead, the loan reviews focused only on identifying patterns, trends, and potential areas of risk. In addition, ORMA had not conducted a loan review since October 2014,[41] and the number of active multifamily loans had increased by 384 since then. The memorandum did not clearly define what was required in the compliance review component. Specifically, it stated that ORMA would conduct compliance reviews but later stated that the purpose of the reviews was not to question the actions and decisions of underwriters and loan committees. A compliance review essentially is an assessment of whether an organization follows certain requirements. Therefore, a compliance review should consider whether the actions and decisions of an underwriter or loan committee followed MAP requirements.

An adequate and continuous monitoring system could have identified the types of deficiencies discussed above. See table 1 for a summary of the underwriting deficiencies.

Conclusion

The Office of Multifamily Production did not require lenders to adequately address a number of key components in the underwriting process, including but not limited to the eligibility of principals and contractors, appraisals, project revenue, market studies, financial capacity, and the completion of critical repairs before approving loans for insurance. This condition occurred because HUD did not enforce and comply with MAP underwriting requirements applicable at the time and maintain an adequate monitoring system for the MAP program. As a result, HUD inappropriately approved nine loans submitted by six MAP lenders, which exposed the FHA insurance fund to unnecessary risk.

Recommendations

[40] As stated in the Background and Objectives section of this report, the Office of Multifamily Production falls under the Office of Multifamily Housing Programs.

[41] Based on the current Memorandum of Understanding, 5 loans would be reviewed per month by ORMA; therefore, at least 80 loans were not reviewed at the time of our audit.

We recommend that the Principal Deputy Assistant Secretary for Housing to require the Office of Multifamily Housing Programs to

1A. Revise its memorandum of understanding with the Office of Risk Management and Assessment to ensure that loans approved by the Office of Multifamily Production are reviewed for compliance with MAP underwriting requirements.

1B. Coordinate with the Office of Risk Management and Assessment to conduct compliance reviews of loans approved by the Office of Multifamily Production that have not been completed since October 2014.

Finding 2: The 2016 MAP Guide Needed Further Improvement

The 2016 MAP Guide was not sufficiently revised and could be further improved and modified. Based on the deficiencies cited in finding 1 of this report, we identified further improvements that could be made to certain underwriting components of the 2016 MAP Guide. The improvements would strengthen the MAP Guide and correct inconsistencies with the (1) onsite physical inspections by appraisers, (2) justification of loan decisions, (3) valuation process, and (4) Single Underwriter model. This condition occurred because HUD did not fully consider all areas of improvement in risk prevention. By missing these underwriting components, HUD may have missed the opportunity to develop stronger MAP Guide to reduce risk exposure.

The MAP Guide was originally published in May 2000 and revised in March 2002, November 2011, and January 2016. The 2011 MAP Guide included updates to requirements presented in the 2002 MAP Guide, which strengthened controls in some areas. For example, the 2011 MAP Guide included an update that may have prevented a deficiency identified in our review of Amaranth's[42] underwriting discussed in finding 1 of this report. Specifically, at the time of underwriting for Amaranth, the 2002 MAP Guide required the lender to practice due diligence and prudent underwriting practices. However, the 2011 MAP Guide was updated to include details regarding asset values reported on financial statements. The 2011 MAP Guide required the lenders to obtain principals' real estate-owned and mortgage debt schedules to support asset values reported on the financial statements.

During the implementation of the Multifamily for Tomorrow transformation, HUD further revised the MAP Guide in 2016. The 2016 MAP Guide included numerous changes made to clarify or correct items in the 2011 MAP Guide. The revisions included but were not limited to (1) the incorporation of guidance issued in mortgagee letters, (2) tax credits, (3) substantial rehabilitation, (4) workload distribution, (5) processing changes, and (6) commercial space. The 2016 MAP also included an update that may have prevented a deficiency identified in our review of Temtor's[43] underwriting discussed in finding 1 of this report. Specifically, the 2016 MAP Guide included language regarding how lenders should address tax increment financing income. At the time of underwriting for Temtor, the 2002 MAP Guide did not provide guidance for how tax increment financing should be treated.

Underwriting Components Could Be Improved

HUD revised and published its 2016 MAP Guide during our audit. We reviewed the revised 2016 MAP Guide and determined that it could be further improved for certain underwriting components. Our review the 2016 MAP Guide was limited to the underwriting components, which were identified as deficiencies in Finding 1 of this report and the overall review and approval process; therefore, we did not form an opinion on the adequacy of the MAP Guide in its entirety.

[42] Audit report number 2015-AT-1003, issued on June 30, 2015.
[43] Audit report number 2015-KC-1005, issued on August 4, 2015.

HUD's Departmental Management Control Program handbook[44] explains that HUD will establish and maintain a cost-effective system of management controls to provide reasonable assurance that programs and activities are effectively and efficiently managed and to protect against fraud, waste, abuse, and mismanagement. Based on our review, the 2016 MAP Guide we identified further improvements could be made to strengthen the MAP guide and correct inconsistencies with (1) onsite physical inspections by appraisers, (2) justification of loan decisions, (3) the valuation process, and (4) the Single Underwriter model.

Execution of Onsite Physical Inspections Could Be More Clear

The 2016 MAP Guide did not clearly show whether onsite physical inspections will be conducted by HUD review appraisers. Paragraph 7.18.E of the Workload Sharing section of the 2016 MAP Guide stated that workload sharing arrangements may require the HUD review appraiser to perform reviews without conducting a physical inspection. The assignment will generally be completed with the appraiser making certain assumptions, such as that the condition is consistent with photographs and other reports.

HUD's senior management explained that USPAP allows for appraisal desk reviews without a physical site inspection. However, the 2016 MAP Guide did not discuss conducting HUD review appraiser desk reviews without a physical inspection. We acknowledge that USPAP allows for appraisal reviews without physical site inspections. However, each valuation appendix in the 2016 MAP Guide included a HUD review appraiser certification stating the appraiser personally conducted a physical inspection of the subject property.

Justification of the Loan Decision Not Fully Documented

Paragraph 7.18.D of the Loan Committees section of the 2016 MAP Guide provided that HUD review appraisers are expected to complete workload assignments to facilitate loan approval (or rejection), including an executive summary and other material. The summary is intended to allow management the ability to efficiently complete its reviews and conclusions. Management has the right to disagree with conclusions made by HUD review appraisers or any other technicians. Management should document in the file the reasons for any disagreement.

The requirement allows management to disagree with the conclusions developed by the technical staff as long it documents the reasons for disagreement. However, implementing the requirement as written creates a control weakness because it does not require management to provide adequate documentation in addition to providing a reason to justify why it overruled the conclusions and recommendations of all technical staff. Based on the deficiency cited in finding 1 of this report, during our review of the Amaranth's underwriting, we found that the HUD management did not fully consider conclusions formed by its technical staff.

Compliance with Appraisal Standards Could Be Clearer in Updated Valuation Process

Paragraph 7.1.D of the Valuation Analysis and Market Analyst section of the 2016 MAP Guide

[44] HUD Handbook 1840.1, REV-3, section 1-2

stated, “in all cases, a qualified HUD employee must review each appraisal for compliance with USPAP and HUD requirements.”

This requirement could be clarified to prevent a potential control weakness. Based on the prior versions of the MAP Guide (2002 and 2011), we determined that HUD previously complied with appraisal standards in USPAP Standard Rule 3 by including an appendix, which had a certification executed by a USPAP-certified HUD appraiser. The 2016 MAP Guide includes appendixes with a similar certification statement, which requires the appraiser’s name and license number. However, the requirement conflicts with what is provided in the appendixes. Specifically the requirement in the body of the MAP Guide explains that a HUD employee must review the appraisal for USPAP compliance; however, the appendixes provide a certification for a USPAP-certified appraiser and not just any employee.

Single Underwriter Model Not Clearly Outlined

A comprehensive outline of how HUD plans to implement the Single Underwriter model is vital, considering the large loan amounts[45] associated with these transactions. According to the Deputy Director of the Office of Multifamily Production, the purpose of the Single Underwriter model is to allow for one underwriter to manage the end-to-end review of the application by drawing in technical experts, such as construction analysts and appraisers, as needed to (1) increase the efficiency of processing applications, (2) provide improved customer service, and (3) help better manage risk. However, the 2016 MAP Guide did not clearly outline the implementation of this new process.[46] Specifically, the 2016 MAP Guide did not clearly explain who would determine whether the use of a technical specialist would be required. For example, one section of the 2016 MAP Guide[47] provides that the underwriter will make the decision, while another section explains that the production team will do so.[48] The 2016 MAP Guide also did not clearly explain how the determination of whether the use of a technical specialist would be required for a limited review or full review.

HUD’s training material for the Single Underwriter model outlines the updated process in detail. Specifically, the training material explained the processing under the model as shown in table 6.

Table 6: Detailed outline of the Single Underwriter model process

Step	Step description	Responsible party	Process
1	Perform intake	Housing program assistant	- Receive application - Route to next available underwriter analyst - Notify branch chiefs - Track workload by branch; create reports for

[45] The MAP loan amounts insured from fiscal years 2010 through 2015 ranged from $287,000 to $190 million with an average of more than $10 million.
[46] Before the Single Underwriter model, each part of the loan was always reviewed by a technical specialist.
[47] Paragraph 4.4.A.1 of the HUD Processing section of the 2016 MAP Guide
[48] Paragraph 4.4.A.4 of the HUD Processing section of the 2016 MAP Guide

Step	Step description	Responsible party	Process
			division director
2	Check completeness	Underwriter analyst	- Check completeness of application, flag missing components, and follow up as needed
3	Assess risk via the New Early Warning System (NEWS)	Underwriter analyst	- Enter into Development Application Processing[49] - Generate FHA number - Conduct quantitative portion of NEWS[50] to provide insight into the level of risk and expertise required to process application - Load materials onto regional SharePoint - Send results to branch chiefs
4	Check capacity within the region	Underwriter branch chiefs	- Branch chiefs coordinate via email to validate complexity, determine capacity, and route to branch - One branch chief designates workload distribution - Lead tracks capacity and works with national workload sharing coordinator
5	Assign underwriter & technical specialist	Underwriter & technical specialist branch chiefs	- Underwriter branch chief assigns underwriter - Technical specialist branch chief assigns technical specialist - Underwriter branch chief and technical specialist branch chief inform staff of assignments
6	Collaborate on processing of application	Underwriter and technical specialist	- Collaborate on processing without supervisor involvement - Flag issues to respective branch chiefs as they arise (for example, need for greater level of expertise than expected) for resolution

HUD's senior management explained the intake and underwriting process consistently with what was provided in the training material. However, as stated above, the 2016 MAP Guide did not reflect what was explained by HUD officials and what is listed in the training material. In addition, the 2016 MAP Guide did not include the training material as an appendix. HUD's senior management also explained that its written procedures are the MAP Guide. Furthermore,

[49] The Development Application Processing system is used for analyzing, processing, and tracking applications for FHA mortgage insurance for loans to purchase, refinance, or build multifamily housing and health care facilities.
[50] NEWS is a new system developed by Multifamily. HUD explained that NEWS will standardized the early warning system and introduce additional risk assessments, working across key underwriting dimensions (loan, borrower, market, etc.)

the training material is not a formal document, which will be signed and issued by HUD officials.

Regarding training HUD staff on the Single Underwriter model, the Deputy Director of the Office of Multifamily Production said that comprehensive training was being provided and planned for current staff. However, the training needs of new staff had not been addressed.

Development of the Revised 2016 MAP Guide Could Have Been More Comprehensive

The 2016 MAP Guide could be further improved to strengthen underwriting components and correct inconsistencies with the (1) onsite physical inspections by appraisers, (2) justification of loan decisions, (3) valuation process, and (4) Single Underwriter model. This condition occurred because the Office of Multifamily Production did not fully consider all areas of improvement in risk prevention.

The Office of Multifamily Production explained that it would not be able to address the issues identified in the report right away because the MAP Guide was published in January 2016. Therefore, it would not be able to update the requirements until the next revision to MAP Guide, which may not be until 2018 or 2019. However, the Office of Multifamily Production has the authority to issue alternative formal clarification to address the weaknesses and inconsistencies before that time.

Conclusion

We identified needed improvements and inconsistencies with certain underwriting components and the overall review and approval process in the 2016 MAP Guide. Because HUD did not fully consider all areas of improvement in risk prevention, it may have missed the opportunity to develop a stronger MAP Guide to reduce risk exposure.

Recommendations

We recommend that the Acting Deputy Assistant Secretary for Multifamily Housing Programs require the Office of Multifamily Production to

2A. Update the valuation appendixes to reflect the requirements provided in paragraph 7.18.E of the 2016 MAP Guide. The updated requirements should be included in the MAP Guide when it is formally revised.

2B. Update the requirements provided in paragraph 7.18.D of the MAP Guide by issuing alternate guidance to require management to provide adequate support documentation to justify loan approval in instances in which technical staff and underwriters recommend or conclude that a loan should not be approved. The updated requirements should be included in the MAP Guide when it is formally revised.

2C. Update the requirements provided in paragraph 7.1.D of the 2016 MAP Guide by issuing alternate guidance to ensure USPAP compliance when the reviewer is not an appraiser. The updated requirements should be included in the MAP Guide when it is formally revised.

2D. Update the requirements provided in paragraph 4.4.A of the 2016 MAP Guide by issuing alternate guidance, which clearly outlines who will determine whether a technical specialist will be used for each part of a loan under the Single Underwriter model and how that determination will be made. The updated requirements should be included in the MAP Guide when it is formally revised.

2E. Formalize a detailed training program process to ensure that new employees hired after the multifamily transformation is complete are familiar with the Single Underwriter model.

Scope and Methodology

We conducted the audit from September 2015 through March 2016 at HUD's Office of Multifamily Production headquarters in Washington, DC, HUD offices in Fort Worth, TX, and Jacksonville, FL, and the Atlanta, GA, HUD Office of Inspector General (OIG) regional office. The audit covered the period March 2002 through November 2011 and was adjusted as necessary.

The review was conducted based on information contained in the lenders' and HUD's project files[51] with no reliance on systems used and maintained by lenders and HUD. The records obtained from the lenders and HUD, which we reviewed for audit evidence, were not computer generated or based. Therefore, we did not conduct an assessment of data reliability.

To accomplish our objectives, we

- Reviewed organizational charts effective from 2002 to 2015;
- Reviewed applicable laws, regulations, and relevant HUD program requirements, including HUD's MAP Guide revisions in 2002, 2011, and 2016;
- Reviewed policies and procedures that govern the MAP program related to the review and approval of loan applications for endorsement;
- Interviewed Office of Multifamily Production, Office of Risk Management and Assessment, HUD's Lender Quality and Monitoring Division, and applicable field office staff to obtain an understanding of the controls significant to the audit objective;
- Interviewed Office of Multifamily Production and applicable field office staff to obtain background information on each project and determine the cause of the underwriting deficiencies;
- Reviewed lenders' and HUD's project files for the subject loans;
- Reviewed eight external HUD OIG audit reports for each of the subject loans;

[51] We obtained and reviewed each of the external audits, which included and discussed information contained in the lender project files.

We conducted the audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Internal Controls

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objectives:

- Policies and procedures to ensure that the Office of Multifamily Production complied with laws and regulations for the review and approval of MAP loans.

- Policies and procedures to ensure that the Office of Multifamily Production provided reasonable assurance that the MAP program was effectively and efficiently managed to ensure that the FHA fund was not exposed to unnecessary risk.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Significant Deficiency

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

- HUD failed to comply with and enforce MAP requirements to adequately review and approve MAP loans (finding 1).

Appendix

Appendix A

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation	Auditee Comments

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

OFFICE OF HOUSING

MEMORANDUM FOR: Nikita N. Irons, Regional Inspector General for Audit, Atlanta Region, 4AGA

FROM: Edward Golding, Principal Deputy Assistant Secretary for Housing

THROUGH: Priya Jayachandran, Deputy Assistant Secretary, Office of Multifamily Housing

SUBJECT: Response to 2016-AT-XXXX; HUD Did Not Enforce and Sufficiently Revise Its Underwriting Requirements for Multifamily Accelerated Processing Loans

This memorandum is in response to Office of Inspector General (OIG) Report 2016-AT-XXXX, prepared on the Multifamily Accelerated Processing (MAP) program, received on April 13, 2016. The audit concluded that HUD failed to maintain an adequate monitoring system, and did not enforce and sufficiently revise the underwriting requirements in its MAP Guide for MAP loans.

The audit cites nine loans, originated over a period seven to fourteen years ago, which were the subject of previous audits, enforcement action, and training. Greater HUD review of these projects during the approval process might have avoided these defaults through rejection or revision of the transactions. Under the MAP Program, the originating MAP lender has primary responsibility for underwriting and recommending approval of the loans, and the lenders' due diligence processes were the subject of the previous audits and findings. The Office of Housing responded to each of those audits and we believe that there are no open items from those audits other than resolution of pending enforcement action.

Comment 1

In the period since origination of the last loan evaluated in the audit (2009), HUD has instituted substantial risk mitigation measures and structural changes to our organization to improve risk management. Revised underwriting parameters and loan committee review requirements for loan approval have been effective in reducing default rates. The Offices of Risk Management, and Multifamily Housing Programs, meet monthly to monitor risk and evaluate trends in our portfolio and pipeline. The Multifamily Transformation has made structural changes to the organization focused on effective risk management. The consolidation of field offices and extensive training program for all Multifamily Production staff and all Multifamily Asset Management staff is four-fifths complete, and will be complete by the end of this fiscal year. We will evaluate best practices and make continuous process improvements, including issuing appropriate administrative guidance in Fiscal Year 2017 to address lessons learned from operational experience and the specific comments in your report. As a result of these structural changes, we believe that the FHA multifamily mortgage insurance platform today is better, stronger, and more appropriately

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Ref to OIG Evaluation	Auditee Comments

organized to manage risk than it has been in many years. Indeed, as noted in the audit, "As of September 2015, the program's default percentage of unpaid principal balance had decreased to 0.15 from a default rate of 1.65 in September 2010."

The following are our specific responses to the recommendations in your report:

IG Recommendation 1A: Revise Memorandum of Understanding with the Office of Risk Management (ORM) to ensure that loans approved by the Office of Multifamily Production are reviewed for compliance with MAP Underwriting requirements.

Comment 2

Housing's Response: The Memorandum of Understanding between the Office of Multifamily Programs and the Office of Risk Management (ORM) to provide for periodic loan reviews will be revised and executed prior to the end of the fiscal year. The focus of those loan reviews is on risk more than compliance, per se; while reviews may identify compliance issues, the primary focus is to ensure appropriate identification and mitigation of major risks. As noted earlier, structural changes made to the processing of a mortgage insurance application ensure a greater focus on both risk and compliance. The newly published MAP Guide and the training and seminars on the Guide, the extensive training of all Production staff as part of Multifamily Transformation, HUD Multifamily Production assignments based on the complexity and risk of transactions to the appropriately trained staff, and approval delegations and loan approval process, including graduating levels of loan committee review for complexity and risk are all improvements that reduce risk.

IG Recommendation 1B: Coordinate with the Office of Risk Management to conduct compliance reviews of loans approved by the Office of Multifamily Production that have not been completed since October 2014.

Comment 3

Housing's Response: In light of the guidance, training, and programmatic and organizational changes made over the past few years, HUD disagrees with the value of conducting targeted compliance reviews for loans originated during that period. Rather, per the revised MOU with ORM, ORM will conduct risk reviews starting in October 2016 for loans with Commitments issued after 2016. The Multifamily Asset Counterparty Oversight Division will also review any early defaults which occur for loans originated in Fiscal Years 2015 and 2016, and separately require the Lender to obtain third party Quality Control Reviews to identify areas of non-compliance. We believe that these two steps will be effective for monitoring compliance and limiting risk.

IG Recommendation 2A: Update the valuation appendices to reflect the requirements provided in paragraph 7.18E of the 2016 MAP Guide. The updated requirements should be included in the MAP Guide when it is formally revised.

IG Recommendation 2B: HUD will update the requirement provided in paragraph 7.18.D of the MAP Guide by issuing alternate guidance, requiring management to provide adequate support documentation to justify loan approval in instances in which technical staff and underwriters recommend or conclude that a loan should not be approved. The updated requirements will also be included in the MAP Guide when it is formally revised.

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Ref to OIG Evaluation	Auditee Comments

IG Recommendation 2C: Update the requirements provided in paragraph 7.1.D of the 2016 MAP Guide by issuing alternate guidance to ensure USPAP compliance when the reviewer is not an appraiser. The updated requirements should be included in the MAP Guide when it is formally revised.

IG Recommendation 2D: Update the requirement provided in paragraph 4.4.A of the 2016 MAP Guide by issuing alternate guidance which clearly outlines who will determine whether a technical specialist will be used for each part of a loan under the Single Underwriter model and how that determination will be made. The updated requirements should be included in the MAP Guide when it is formally revised.

Comment 4

Housing's Response to Recommendations 2A, 2B, 2C, and 2D: The MAP Guide revisions published January 2016 incorporated all of the Office of Inspector General's comments received during the clearance process. We appreciated those comments, and also the recommendations in your audit report, which were received after publication of the MAP Guide. Multifamily Production will issue administrative guidance in Fiscal Year 2017 to address the specific issues raised in these four recommendations after such time we have evaluated the impact of the Multifamily Transformation, and will formally address them in the next MAP Guide revision.

IG Recommendation 2E: Formalize a detailed training program to ensure new employees hired after the Multifamily Transformation is complete are familiar with the Single Underwriter model.

Comment 5

Housing's Response: We have provided extensive training to each employee in the Production offices over the past two years to implement the Multifamily Transformation and new Underwriter model. We agree and will undertake the development of a training plan for employees joining after the Transformation training is completed.

Thank you for your report and recommendations. Please contact Daniel J. Sullivan, Acting Director of Multifamily Production, if you have any questions about this memorandum.

OIG Evaluation of Auditee Comments

Comment 1 HUD stated it will evaluate best practices and make continuous improvements to address lessons learned from operational experience. HUD's Departmental Management Control Program handbook,[52] states management control is an ongoing process requiring managers to evaluate their programs and establish appropriate controls to ensure that HUD programs and activities are efficiently and effectively managed; protect against fraud, waste, and abuse; and follow applicable laws and regulations. Accordingly, we agree with the Office of Multifamily Production's proposed action that best practices should be evaluated for continuous process improvements.

Comment 2 HUD agreed to revise its Memorandum of Understanding (MOU) with the Office of Risk Management before September 30, 2016. We appreciate HUD's acknowledgement of the monitoring issue and its plan to take action to include a compliance facet for its monitoring reviews.

Comment 3 HUD did not agree with recommendation 1B and stated that it would not conduct the compliance reviews that were missed since October 2014. Instead, HUD stated that it will conduct compliance reviews for firm commitments starting in October 2016, which will coincide with the updated MOU. HUD also stated that it will review any early defaults, which occur for loans originated in fiscal years 2015 and 2016. We acknowledge the updated MOU will include a compliance function. However, as stated in finding 1, at least 80 loans were not reviewed since October 2014 and if HUD does not complete the missed compliance reviews, it will miss the opportunity to identify potential fraud, waste, and abuse in these loans. Therefore, HUD should implement recommendation 1B.

Comment 4 HUD agreed to address the needed improvements and inconsistencies identified in the 2016 MAP Guide by issuing administrative guidance in Fiscal Year 2017. While administrative guidance will serve as interim clarification, the updated requirements should be included in the MAP Guide when it is formally revised.

Comment 5 HUD agreed to develop a training program for new employees hired after the transformation is complete. We appreciate HUD's willingness to improve the MAP program and to strengthen its controls over it by focusing on staff training.

[52] HUD Handbook 1840.1, REV-3, Policy