

How Things Should Work

What To Do When Things Go Wrong

What Can Happen If You Don't

Managing a HUD Construction Loan

How to Navigate through some common deal troubles.

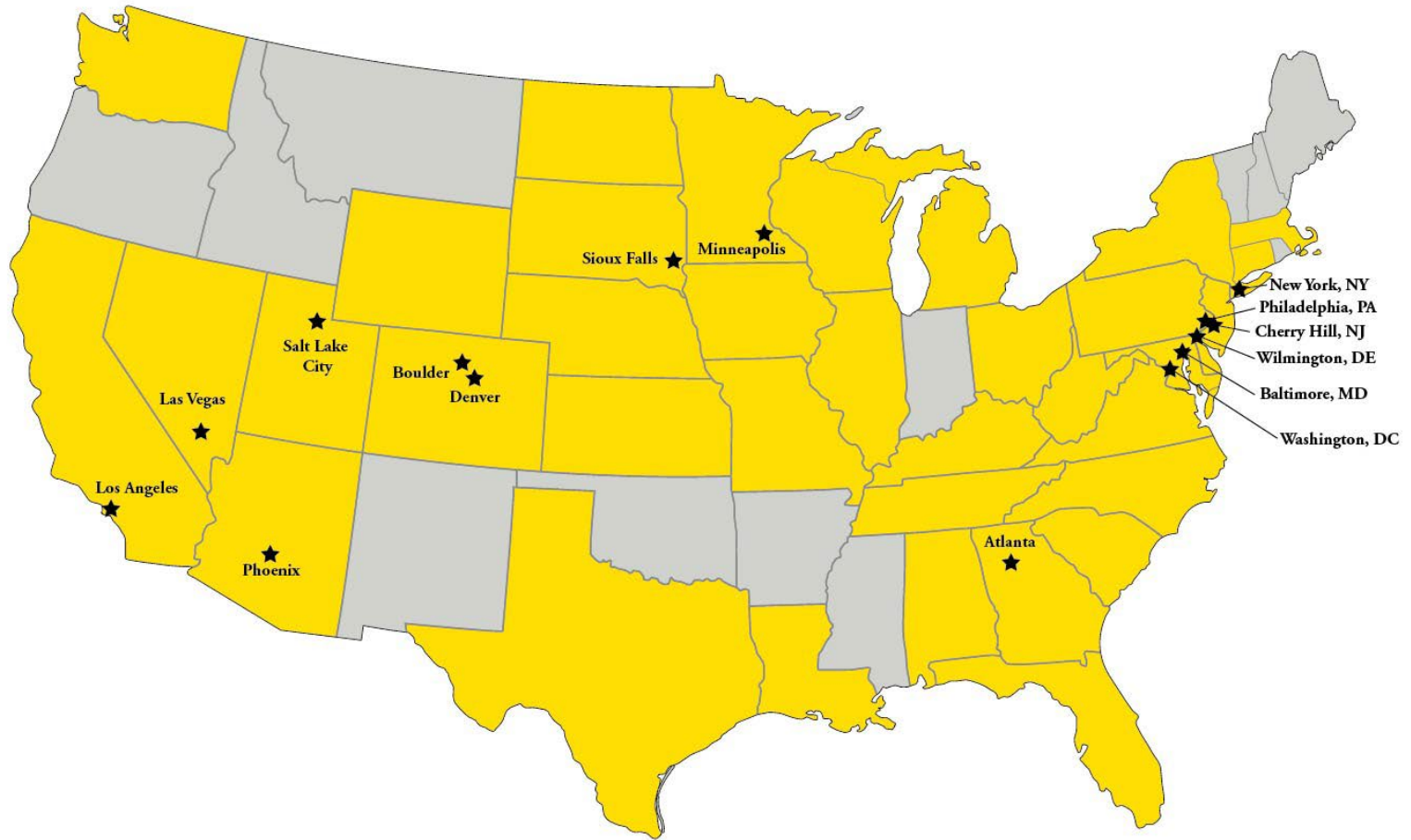
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Ballard Map



Introduction & Overview

- Construction Administration Responsibilities
- Inspections
- Advances
- Change Orders
- Contractor/Owner Disputes
- Liens
- Cost Certification
- Communications – Best Practices
- Loan Default
- Regulatory Agreement Violations

Introduction & Overview Continued

- Why is all this Important?

Introduction & Overview/Lender Liability

HUD – Claims based on

- Alleged Violations of Guides, Regulatory Agreement, Program Requirements, Regulations.

Borrower – Claims based on

- Contract/Quasi-Contract/Tort
- Interference with Business Relationships

Third Party – Claims based on

- Interference with Business Relationships
 - Quasi-Contract/Tort

HUD Current Enforcement Atmosphere

- HUD was very active during Obama Administration
- FCA against Single-Family Lenders 2009-2017 \$7 Billion
- 2005-2016 explored and asserted some claims against multi-family lenders.
- At beginning of 2017, 14 open investigations by HUD, HUD OIG, and/or DOJ
- By 2019 all disappeared. (MOU)
- They're back – “Whatever they bring us!”

HUD – Recent Enforcement Actions

- Broker Requirements
- IOI
- Green/Affordable Fee limitations
- FHA 223f repair cost limits
- “Whatever they bring us”

Minimize Risk

- Know your loan documents
- Know your regulatory agreement
- Know the Map Guide
- Know your responsibilities as lender/servicer
- Document, document, document

Borrower/Third Parties – Minimize Risk

- Know your loan documents
- Know your regulatory agreement
- Know your responsibilities as lender/servicer
- Do not interfere with borrower operations
- Consider whether it is appropriate to talk to third party and, if so, whether borrower should be present
- PNA and/or Disclaimer
- Document, document, document

Communications- Best Practices

- The “E” in E-Mail stands for EXHIBIT!



Do You Want to Have to See or Explain This?

FHFA v. Nomura. \$800+ million judgment.

Internal emails regarding the mortgages underlying a bond issuance Nomura was underwriting. Several emails characterized the mortgages as “lemons,” “junk,” or “pigs.” Cross examination of an employee who wrote: “This one is crap.”

Question: “Sir, ‘crap’ is never used in a positive sense is it?”

Answer: “Nothing comes to mind.”

Do You Want to Have to See or Explain This?

U.S. Justice Department and State AGs secured a \$1.375 Billion settlement with Standard & Poor for defrauding investors through its investment ratings in the lead up to the 2008 Financial Crisis.

Here's an instant message from an employee at S&P before the 2008 housing market crashed:

"We rate every deal. It could be structured by cows and we would rate it."

And Text Messages, Too.



Is e-mail the best method of communication for the matter in question?



Moody's vs S&P

As explained in a WSJ 2013 article entitled "Two Firms, One Trail in Probes on Ratings" as to why the government pursued claims against S&P but not rival rating agency firm Moody's:

It is because Moody's "...took careful steps to avoid creating a trove of potentially embarrassing employee messages like those that came back to haunt S&P."

The article further explained that Moody's analyst "in recent years had limited access to instant-message programs and were directed by executives to discuss sensitive matters face to face."

Communications – Best Practices

1. Consider whether a phone call is the appropriate first step.
2. When a communication is in writing, keep it professional. Treat email/internal texting apps as if they are formal letters. If there is litigation, your words may be read back to you (if the privilege does not apply).
3. Clearly identify communication participants (consider using formal titles).
4. Make clear if a communication is for purpose of receiving legal advice.
5. To the extent possible, limit communication to the issue at hand – don't raise extraneous issues or multiple matters.
6. Avoid routine copying of in-house counsel on non-legal communications unless legal issues have been raised and counsel needs to be aware of status.

Lender Liability Risk Management Best Practices

The risks we have talked about cannot be eliminated but they can be mitigated...



Document the Process

- Notices of Default & Acceleration
- Respond to Borrower communications, offers and post-default payments
- Email disclaimers/reservations of rights
- “No Deal”, “Partial Payment” & “Reservation of Rights” letters
- Borrower cannot establish reasonable reliance in face of written communications stating the contrary

Document the File

- Document your file after every substantive interaction
 - Make sure they are professional, unbiased and accurate
 - Avoid nicknames, judgmental or derogatory comments
- Get any necessary third party (i.e., Freddie Mac/CCR/DCH) consents in writing

Document the Deal

- All agreements with Borrower should be in writing (no matter how short)
 - Should specifically identify which provisions of loan documents are being modified
 - And ratify those that are not (curative process)
- Should be signed by Borrower & Guarantor
- Should include integration, modification, and waiver language

Document Compliance

- Be consistent internally
 - Follow internal policies and procedures
 - Obtain all requisite internal approvals before taking (*or promising to take*) action (Don't get over your skis with the Borrower's sponsor)
 - Ensure proper training for all who communicate with Borrowers
 - Pay attention during hand-offs
 - If deviation occurs from established practices and procedures, document why such deviation

Document Your Good Faith

- Avoid “Surprising” the Borrower
 - Give Borrower notice before taking action that might impair the Borrower’s operations or finances
 - Act on short notice only when absolutely necessary to ensure repayment or preserve collateral
 - Do not change course of dealing with Borrower until you inform Borrower that you’re changing course
 - Examples—No Management Agent, Security/Life & Safety Issues

Don't Trigger New Duties to Borrowers

- Avoid Getting Involved in Management of Borrower (control issue)
 - Respect the creditor/debtor relationship and stick to what is required under loan documents
 - Do not otherwise participate in the management of the Borrower's business
 - Do not advise the Borrower on business decisions
 - Do not make personnel decisions for Borrower
 - Be careful what you say to third parties about Borrower

Documenting Deals and Work-Outs

- EXAMPLES
- Distressed but not “moving”
 - Dispute with a Management Agent. Borrower asks you to talk to them directly (Do you talk to the third party directly? Get on phone w/HUD and Management Agent without Borrower?)
 - Monetary Default, but sale is contemplated
 - Can you help the Borrower find a buyer? Third party communications. [EXAMPLE—two offers same sale]
 - Prenegotiation Agreement
 - Are payments being made in the interim? How long do you wait?
 - HUD should be aware & sign-off any forbearance agreement, and remember to extend election to assign.
 - Is the Borrower also facing enforcement action?

Documenting Deals and Work-Outs

- Forbearance Agreement
- Every recital should be appropriate—they are joint & HUD is signing off on them. Advocating adverse positions
- Think about additional liability—weigh against offers for work-outs
 - Assignments vs receiverships or a sale
 - Forbearance Agreements that give Borrower more time or “chances” to violate provisions w/new notice & cure provisions

Despite Everything...

- What to do if Borrower starts rattling the “Lender Liability” sword
 - First, do nothing
 - Do not immediately respond to Borrower
 - Do not put anything in writing
 - Do not make any changes to your loan servicing file
 - Second, do something
 - Talk to supervisor
 - Talk to counsel

Construction Issues

- Steps to take if Contractor delayed
 - Construction Problem? General Contractor abandonment?
 - Financing Problem?
 - FHA 223(f) loans and statutory repair cost thresholds (watch local tax credit agency rules)

Construction Issues

- Liens on Project & Disputes with Materialmen
 - When to call the Surety and steps to take
 - How to handle if we have a completion assurance agreement and no P&P Bonds
 - Secondary Lender and other financing partner approvals (language re continuing to fund)
 - Title coverage and date downs. Stop funding.
 - What if Surety does not cooperate?

Early Signs of Distress

- Look for Early Signs of Distress in Inflationary environment
 - Pay attention to the draws coming in (longer time between requisitions)
 - Review Trip Reports
 - Change Orders (Heavy 223(f)s and stat limits)
 - Reach out regularly to Borrower to check on progress, ask questions as to pending disputes/concerns, arrange meeting to discuss among parties if necessary
 - Review schedule of equity contributions from Tax Credit Investor and inquire (hitting benchmarks? Delay and causes?)

Extension Fees & Prepayment

- Delays in construction and/or in providing cost certifications can result in imposition of Extension Fees
- Prepayment may not be an Option
- Check Note Rider Prepayment Provisions & HUD override provisions
- Depends on terms of the commitment with the Ginnie Mae investor/loan participant
- Deadline for filing claims with HUD (MAP Lender must request a 3 month extension)
- Extension Fees – Unenforceable Penalty?

Final Closing & GC Involvement

- Getting to Final Closing w/o full GC Involvement
 - RC Director can waive non-stat & non-reg requirements
 - Narrative good faith efforts made to resolve dispute
 - Supplemental Opinion of Borrower's Counsel to address potential liens
 - Clean title
 - Evidence all relevant parties notified of request to proceed to final while disputes are pending

Final Closing & GC Involvement Cont.

- GC Requisition and Prevailing Wage Certificate
- DBLS/DOL Clearance (can be conditional letter)
- Request for Final Endorsement may require modification for Borrower and GC to sign
- Escrow Delayed Completion and Escrow for Incomplete Construction
- Remaining mortgage loan proceeds (and additional sums if required) to be escrowed pending outcome of dispute

Overall goals:

- Get to Final Endorsement, Satisfy GNMA investor, Preserve the Contract of Mortgage Insurance but avoid a Claim
- Minimize extension fees to borrower (default risk)
- Possibly minimize liquidated damages
- Watch timelines for notices of default, election to assign, etc.
- Document Everything and Be Cautious of Lender Liability and Be Aware of Parameters of the Lender Role