



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

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OFFICE OF HOUSING

MEMORANDUM FOR: All Approved Mortgagees
All Multifamily Hub Directors
All Multifamily Program Center Directors
All Multifamily Operations Officers

FROM: 
Mark B. Van Kirk, Director, Office of Asset Management, HTG

SUBJECT: Submission and Analysis of Borrower Financial Statements

This memorandum is written to encourage all HUD approved Mortgagees to collect and analyze your Borrowers' annual audited financial statements (financial statements) as part of an overall effort to assess the level of risk associated with each loan in your FHA-insured portfolio. Maintaining a system for determining the level of risk associated with each loan and developing a "Watch List" of distressed loans is a prudent business practice that will help determine the overall health of a Mortgagee's portfolio, help Mortgagees focus on their most distressed assets, and help prevent FHA mortgage insurance claims.

The Department considers the collection and analysis of a Borrower's financial statements one of the most important steps that a Mortgagee can take to avoid an insurance claim. The Code of Federal Regulations at CFR 24, Part 25, Section 25.9, provides a list of violations by a Mortgagee that may result in an administrative action by the Mortgagee Review Board. Section 25.9(p), states that using business practices that do not conform to the generally accepted practices of prudent Mortgagees or which demonstrate irresponsibility may constitute grounds for administrative action. Furthermore, Section 25.9(l) states that failure to properly perform underwriting, servicing or property disposition functions in accordance with instructions and standards issued by the Commissioner may also be grounds for administrative action.

Assessing a loan's financial performance should be an essential part of the risk rating process. Certain financial performance ratios and financial indicators drawn from the Borrowers' financial statements will play a key role in assessing each property's risk score. The Department recently created its own Watch List based on an assessment of the level of risk associated with its insured portfolio and is now assessing the risk of its non-insured portfolio. Ranking the level of risk associated with each project works as an early warning system so that Asset Managers in the Department's field offices can prioritize their workload and focus on high risk assets by placing them on the Watch List.

At present, the Office of Asset Management in Headquarters is conducting teleconference calls with approved Mortgagees to discuss assets that appear on HUD's Watch List and, if they have one, the Watch List of the Mortgagee. These calls involve a discussion of the Department's system

for watching assets as well as the criteria used by the Mortgagee to monitor the component of the FHA-insured portfolio they service. The Department uses these calls to share information and encourage Mortgagees to monitor assets closely. The quarterly Watch List calls also provide an opportunity for Mortgagees to learn from the Department's process and ensure the close monitoring of any troubled assets.

The Department has observed that several Mortgagees maintain a Watch List of only delinquent assets and that some do not maintain a Watch List at all. Other Mortgagees closely monitor all of the assets in their portfolio using a number of criteria, such as, Debt Service Coverage Ratio, REAC Physical Inspection Score, and Escrow Account Levels. As indicated above, the Department strongly encourages Mortgagees to closely monitor assets in this way, using all available financial and asset-specific information, including, most importantly, the Borrower's financial statements.

In the past, some Mortgagees have sought the Department's assistance in obtaining financial statements from Borrowers. **While the Department cannot provide Mortgagees with copies of these financial statements, it can and has encouraged Borrowers to provide Mortgagees with a copy of the statements that Borrowers submit electronically to Form HUD. As you may know, Section 18 of the new regulatory agreement for FHA-insured properties (HUD-92466M Rev. 04/11) states that the Borrower must provide both HUD and the Mortgagee with a complete annual financial report. If you are experiencing difficulty in obtaining a Borrower's financial reports, please contact the HUD Project Manager in the Field Office that has jurisdiction over the project and he or she will assist you in obtaining them. Furthermore, a Borrower's failure to share annual financial reports or other financial information would be grounds for placing that Borrower on your Watch List.**

In the near future HUD anticipates making changes to the Mortgage Delinquency and Default System (MDDR) that would allow Mortgagees to share their Watch Lists with HUD on a monthly basis.

Thanks you for your review and adherence to this memorandum. If you have any questions, please contact Norman Dailey at (202) 402-8371 or Lauryn Alleva at (202) 402-2609.