Property Repair Training

December 7, 2012

(To access the recorded webinar, click here)
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Introductions

Today’s Presenters:

» Michael Lipson, Senior Vice President, Multifamily Asset Management and Operations
» Debby Jenkins, Vice President, Multifamily Underwriting and Credit Management
» Carolyn Flury, Associate General Counsel, Legal Division - Multifamily
» Peter Giles, Director, Multifamily Production Central Region
» Richard Meyer, Director, Multifamily Real Estate Services
» Ian Ouwerkerk, Associate Director, Multifamily Southeast Underwriting
» Karyn Sandelman, Senior Director, Multifamily Asset Management
Key Goals

- Why is Freddie Mac making changes to the Property Repair Conditions?
  - To strengthen our focus on real property-related risk
  - To provide clear definitions to better define our requirements
  - To streamline and improve identification and monitoring of repairs for all involved parties
  - To improve post-closing reconciliation process for Borrowers, Servicers, and Freddie Mac

- What’s Not Changing? Freddie Mac’s commitment to ensuring loans are secured by safe and well-maintained housing
Training Objectives

At the end of today's session you will be able to:

- Classify identified issues into the new property repair categories
- Identify changes in the Property Condition Report (PCR) Form 1105
- Determine what documentation is appropriate for each repair category
- Identify Roles and Responsibilities for all involved parties, particularly with respect to:
  - Engaging a qualified consultant
  - Completing the PCR
  - Confirming the PCR’s compliance with Freddie Mac requirements
  - Preparing appropriate documents for execution
Seller’s Third Party Report Responsibilities

The Seller must:

- Retain and direct qualified consultants
- Review the PCR to ensure it meets Guide requirements, is complete and accurate, and appropriately addresses all risks
- Maintain files regarding consultant qualifications and quality assurance practices for reports
- Ensure that the PCR:
  - Indicates appropriate category for each repair item
    - Critical
    - Priority
    - Operational
  - Excludes all Routine Maintenance items
  - Provides suggested remedies and costs for each Critical and Priority Repair identified
    - If a cost cannot be identified, the PCR must recommend scope for analysis and estimated cost of such analysis
Seller’s Selection of a Property Condition Consultant

Property condition consultant must meet qualifications in Guide 14.8, including expertise to professionally:

- Analyze building systems and site conditions
- Identify deficiencies
- Recommend remedial responses with cost estimates

Property condition consultant must have all of the following:

- Degree in engineering and/or architecture
- Five or more years of relevant experience
- Two or more years of experience conducting similar work for financial institutions

Seller must check at least three references for comparability of work and quality
Property Condition Consultant’s Responsibilities

Property Condition Consultant must:

• Review pertinent information and records in accordance with the Guide (including maintenance reports and inspection records)
• Classify repairs in the correct categories
• Clearly state any limiting conditions or deviations from the Guide or current ASTM standards
• Review information related to planned capital improvements and determine if deficiencies are included in plan
• Inquire about open code violations
• Complete the revised PCR in accordance with the Guide
**Repairs Categorization - What’s new and what has changed?**

<table>
<thead>
<tr>
<th>Category</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Critical Repairs</td>
<td>• New name and definition for work that must be completed prior to commitment</td>
</tr>
<tr>
<td>Priority Repairs</td>
<td>• New name and definition for most significant, non-critical repairs</td>
</tr>
<tr>
<td>Operational Repairs</td>
<td>• New category of repairs</td>
</tr>
<tr>
<td>Replacement Reserves</td>
<td>• Unchanged</td>
</tr>
<tr>
<td>Routine Repairs and Maintenance</td>
<td>• New definition (items not to be included in PCR)</td>
</tr>
</tbody>
</table>


Repair Categories

- Critical Repairs
  - Repairs and replacements that significantly impact habitability, value, income or marketability and that must be corrected before Freddie Mac commits to the deal.
**Repair Categories**

- **Priority Repairs**
  - All Life Safety Hazards, code violations, Material Deficiencies and Significant Deferred Maintenance items are Priority Repairs
    - Material Deficiencies: Unresolved problems that cannot reasonably be addressed by normal operations or Routine Maintenance and which include:
      - Deficiencies which, if left uncorrected, have the potential to result in or contribute to critical element or system failure within one year
      - Deficiencies that will likely result in a significant escalation of remedial cost related to any material building components that are approaching, have reached or exceeded their typical expected useful life or whose remaining useful life should not be relied upon in view of actual or effective age, abuse, excessive wear and tear, poor maintenance and exposure to the elements
      - Any mold, water intrusion, or potentially damaging leaks
Repair Categories

- **Priority Repairs, Continued**
  - Significant Deferred Maintenance: The postponement of normal maintenance, which cannot reasonably be resolved by normal operations or Routine Maintenance and which may result in any of the following:
    - Advanced physical deterioration
    - Lack of full operation or efficiency
    - Increased operating costs
    - Decline in property value
Repair Categories

- **Operational Repairs**
  - Repairs and replacements that consist of Minor Deficiencies and Minor Deferred Maintenance that are expected to be completed by the Borrower as part of a repairs and maintenance budget and that cannot be reasonably resolved by Routine Maintenance.
    - **Minor Deficiencies**: Unresolved problems such as:
      - Deficiencies that are not included in Critical or Priority Repairs
      - Deficiencies that do not warrant immediate attention, but require repairs or replacements that should be undertaken within the next 12 months
      - Deficiencies that cannot be reasonably addressed by Routine Maintenance, and have a cost of more than $3000 per item
    - **Minor Deferred Maintenance**: The postponement of normal maintenance that may result in minor deterioration, lack of efficiency, and/or minor increase in the operating budget and that has a cost of more than $3000 per item.
**Repair Categories**

- **Routine Repairs and Maintenance**
  - Repairs and maintenance that are expected to be completed by the Borrower in the normal course of business and that are nominal in cost. These repairs are not considered to be Critical, Priority or Operational Repairs and include work that is:
    - Often preventative in nature
    - Accomplished within the property’s normal operating budget
    - Typically completed by on-site staff
    - Focused on keeping the property fully functioning and serviceable
  - **Note:** These repairs do not need to be captured on the PCR and should not be included in the Loan Documents
**Section II: New categories**

**Property Condition Report, Form 1105 Changes**

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### Site

Complete the estimated useful life, condition, remaining useful life, action and comments for the applicable items listed below. Indicate the condition using the following abbreviations: **E** = excellent, **G** = good, **F** = fair and **P** = poor. Indicate the action required using the following abbreviations: **CR** = Critical Repairs; **PR** = Priority Repairs; **OR** = Operational Repairs; **RR** = reserve for future repair/replacement. See Section V for a complete description of each repair category. The consultant should attach additional information as needed. The consultant must also note any Mold observations on any component in the comment sections.

<table>
<thead>
<tr>
<th>Item</th>
<th>Estimated useful life</th>
<th>Condition (E, G, F, P)</th>
<th>Remaining useful life</th>
<th>Action (CR, PR, OR, RR)</th>
<th>Comments/Mold Observations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carports</td>
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<tr>
<td>Garages</td>
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<td></td>
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<tr>
<td>Maintenance structures</td>
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<tr>
<td>Trash enclosures</td>
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<tr>
<td>Roadways/Parking lots</td>
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<tr>
<td>Asphaltic concrete</td>
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<tr>
<td>Seal coat</td>
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<tr>
<td>Concrete paving</td>
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<tr>
<td>Integral colored, pattern stamped concrete</td>
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<td></td>
</tr>
</tbody>
</table>
Section III: Immediate Needs table revised to designate Critical and Priority Repairs
Section V: Adds clear category definitions
Once the Seller has received and reviewed the PCR, the Seller must disclose to Freddie Mac any Critical Repairs at the Property by informing the *Applicable Freddie Mac Multifamily Regional Office* or the *Multifamily TAH Underwriter*. Review the following chart for repair categories and required Seller actions:

<table>
<thead>
<tr>
<th>Category</th>
<th>Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Critical Repairs</td>
<td>• Complete work before the deal can proceed. Supply evidence of completion as Freddie Mac will not commit to purchase the loan until work is completely done.</td>
</tr>
</tbody>
</table>
| Priority Repairs  | • Work is to be repaired within a short time frame (typically 90 days but always less than one year) with applicable Loan Agreement repair provisions  
                    • Reserves are required                                                                                                               |
| Operational Repairs | • Non-priority work that must be identified in the Repair Letter and must be completed prior to the first annual inspection  
                       • Not listed in Loan Agreement Exhibit C  
                       • No reserves                                                                          |
Property Repair Training

- Priority Repairs must be described in the appropriate Repair Rider to the Loan Agreement


  - Repair work scope must be described in sufficient detail to be verifiable by the Servicer


  - Work must be completed on a priority basis and in coordination with the Borrower’s plans. In most cases work is to be completed within 90 days, but in any case no longer than 12 months


  - Work completion must be certified by the Borrower and confirmed by the Servicer as required in the loan documents (via a special inspection(s)) or at first annual inspection as required


RIDERS TO MULTIFAMILY LOAN AND SECURITY AGREEMENT
(PORTFOLIO)

REPAIR RESERVE FUND
(Revised 1-11-2012)

The following changes are made to the Loan Agreement which precedes this Rider:
A. Section 4.03 is deleted and replaced with the following:

4.03 Repair Reserve Fund.

[CHOOSE APPROPRIATE VERSION OF SECTION 4.03(a) AS REQUIRED BY THE COMMITMENT OR ERLA]

(a) Deposit to Repair Reserve Fund – Current. Lender and Borrower acknowledge that Borrower has established the Repair Reserve Fund by depositing the Repair Reserve Deposit with Lender on the date of this Loan Agreement, and that Borrower will complete the Repairs as required pursuant to Section 6.14.

[OR]

(a) Deposit to Repair Reserve Fund – Deferred. Lender defers its right to require Borrower to make the Repair Reserve Deposit.

(i) Future Deposit. Upon the occurrence of one or more conditions specified in Section 4.03(i)(ii), Lender may require Borrower to establish a Repair Reserve Fund, in an amount not to exceed the Repair Reserve Deposit.

(ii) Deferral of Deposit. Lender reserves the right to require that Borrower make the Repair Reserve Deposit within 30 days following Notice to Borrower from Lender if Lender reasonably determines that Borrower has failed to take any of the following actions:
Operational Repairs will be identified in the PCR, but not listed in the Commitment/ERLA. The Seller must include Operational Repairs in the Repair Letter (the form of which can be found on FreddieMac.com), but not in the Loan Agreement. The Repair Letter must:

» Be provided to the Borrower by the Seller prior to or on the Origination Date

» Convey that Freddie Mac expects Operational Repairs to be completed by the Borrower as part of a repairs and management budget

» Be checked by the Servicer at the first annual property inspection to confirm completion of Operational Repair items

» Convey that failure to complete repairs may be an event of default by the Borrower
Property Condition Report: Underwriting Review

- Ensure PCR reaches clear conclusions with adequate recommendations – must conform to Section 14.3 of the Guide
- PCR should
  - Identify all repairs by the new repair categories – Critical, Priority, Operational
  - Identify capital needs to be funded over the term of the loan and for which Replacement Reserves will be collected
- Any recommended additional studies must be completed prior to final submission
- Report must include reliance language
- Confirm PCR meets requirements of Section 8.16 of the Guide
  » Exceptions must be justified
- New 1105 must be used for all reports ordered after 1/1/2013, but may be used sooner at the Seller’s option
Property Condition Report: *Underwriting Review*

- Reviewer must confirm repair recommendations:
  - Agreement with repair categorizations (Critical/Priority/Operational)
    - Needed work is identified and sufficiently described
      - Quantity
      - Location
  - Coordinate timing requirements
    - Life safety or materiality
    - Work priority
    - Seasonally realistic
    - Operationally achievable
    - Coordinated with Borrower’s work plan
  - Aim to minimize subsequent Repair Rider changes
    - Less burdensome to administer
    - Less costly to Borrower

*Form 1105 – Property Condition Form*
Property Condition Report: Underwriting Review

- **Priority Repair needs**
  - ✓ 125% reserve required for all items

- **Operational Repairs needs**
  - ✓ Repairs not listed in Loan Agreement - no repair reserves will be required at closing
  - ✓ Requirements documented through a separate Repair Letter included in the loan file
  - ✓ Completion confirmed through Servicer’s Annual Inspection
  - ✓ Allows for reduction of administrative overhead at the Borrower and Servicer level

Form 1105 – Property Condition Form
## Property Condition Report: Underwriting Review

<table>
<thead>
<tr>
<th>COMPONENT</th>
<th>PRIORITY</th>
<th>OPERATIONAL</th>
<th>ROUTINE</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>STRUCTURE</strong></td>
<td>Pervasive; causing damage or presenting risk to tenants; not being addressed; end of useful life; needs priority attention</td>
<td>Limited; causing isolated damage and presenting no risk to tenants; useful life remaining; being addressed as identified and/or can be addressed over a reasonable timeframe</td>
<td>Isolated; not causing damage and presenting no risk to tenants</td>
</tr>
<tr>
<td></td>
<td>The missing downspouts on the buildings have caused erosion such that the foundation wall has moved as evidenced by step cracking. The wall must be stabilized and the landscaping restored.</td>
<td>The groundcover at the NW corner of Building 7 has died back to the recent drought and could be cause for future erosion and structural destabilization.</td>
<td>Hardly any structural issue would be routine.</td>
</tr>
<tr>
<td><strong>ROOFING</strong></td>
<td>Roofing at the end of its useful life (due to age, poor installation, inferior materials, or extreme weather conditions) with extensive leaking causing interior damage.</td>
<td>Roofing with remaining useful life that has limited areas of damage or wear that are cause for isolated leaks which appear to be corrected as identified.</td>
<td>Isolated minor damage caused by a recent weather event that has no impact on weather-tightness now but should be addressed by site personnel to avoid worsening conditions.</td>
</tr>
<tr>
<td><strong>HVAC</strong></td>
<td>Drip trays are not provided throughout the property for the air conditioning condensate lines cause water damage to interior spaces.</td>
<td>The water heater in unit 2B needs to be replaced.</td>
<td>Furnace filters are due to be replaced shortly.</td>
</tr>
</tbody>
</table>
## Property Condition Report: Underwriting Review

<table>
<thead>
<tr>
<th>COMPONENT</th>
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<th>OPERATIONAL</th>
<th>ROUTINE</th>
</tr>
</thead>
<tbody>
<tr>
<td>PAVEMENT</td>
<td>Extreme wear and tear and the lack of preventative maintenance has resulted in extensive cracking and alligating to the asphalt parking areas such that a new 2” top coat is required</td>
<td>Although no extensive weathering has resulted, the seal coat is beyond its useful life and a new seal coat is required.</td>
<td>The parking striping is starting to fade.</td>
</tr>
<tr>
<td>MAINTENANCE</td>
<td>Lack of exterior painting and deteriorated caulking has resulted in property-wide areas of rotted wood trim and interior leakage.</td>
<td>The stucco exterior has limited areas of algae growth that needs to be power washed.</td>
<td>Although all other common areas are in good repair, the laundry rooms need to be repainted.</td>
</tr>
<tr>
<td>EQUIPMENT</td>
<td>The elevator has not been under a service contract and has frequent break downs resulting in the need for repairs.</td>
<td>The elevator inspection has expired.</td>
<td>The elevator cab wall was marred by a recent move-in and requires touch-up</td>
</tr>
<tr>
<td>FINISHES</td>
<td>The hallway carpets in all buildings have excessive wear and need replacement</td>
<td>The fire damaged unit has been restored and carpet remains to be installed.</td>
<td>The carpet in the fitness room is dirty.</td>
</tr>
</tbody>
</table>
Priority Repairs:

- Included in Commitment Letter or Early Rate Lock Application/Adjustment Letter
- Flows to Exhibit C of the Loan Agreement

Operational Repairs:

- Included in separate Repair Letter sent to Borrower prior to origination
- Seller responsible for accurately preparing letter and providing to Borrower
- Copy of letter to be included in final delivery package

Freddie Mac relies on the Servicer to perform a comprehensive annual property inspection, including the monitoring of:

- Operational Repairs identified in the Repair Letter, to ensure that they are completed on schedule
- Compliance with any outstanding Loan Agreement Exhibit C Priority Repair items
Property Repair Reporting Guidance

- Seller/Servicer Guide
  - Section 8.16 – New
    - Seller Responsibilities
  - Chapter 14 – Changed
    - New repair categories
    - The property condition consultant’s requirements for evaluating the physical condition of the Property and completing the PCR
    - The Seller’s requirements for retaining a property condition consultant and reviewing the PCR
Section 8.16 Seller Responsibilities

- **Contract**
  - Retain a qualified consultant to perform the necessary scope of work

- **Review**
  - Verify that the PCR complies with Freddie Mac Guide requirements
  - Determine that the report is complete and accurate
  - If the PCR identified any Critical Repairs, ensure that they have been completed and provide evidence of completion to the consultant and notification to Freddie Mac Underwriting

- **Document**
  - Prepare appropriate loan documentation which includes:
    - Appropriate Repair Rider and a list of all Priority Repairs in Loan Agreement Exhibit C
      - Clearly describe work scope and location
      - Provide reasonable completion schedules that reflect the urgency of the Priority Repair and the Borrower’s plans and capacity
    - A Repair Letter to address all Operational Repairs
      - Describe work so as to be verifiable
      - Confirm completion at the first annual inspection
All the exhibits shown today may be found on FreddieMac.com:

- Property Condition Report, Form 1105

- Repair Letter

- Repair Reserve fund Rider to Loan Agreement
  - [http://www.freddiemac.com/multifamily/docs/Repair_Reserve_Fund_Rider_to_Loan_Agreement_Portfolio.doc](http://www.freddiemac.com/multifamily/docs/Repair_Reserve_Fund_Rider_to_Loan_Agreement_Portfolio.doc)