

Building Code Violations—SBL Guidance

As of July 10, 2017

Engineer and Physical Risk Report (Form 1104) Guidance

- ✓ **Engineer is expected to research any code violations prior to site inspection**
 - Most municipalities/cities have code violation information available on their websites.
- ✓ **Engineer should identify any current underlying physical risk issue(s) associated with individual code violation(s)**
 - If Engineer is having difficulties with such identification, he/she should recommend the evaluation by an applicable certified professional (electrician, elevator engineer, pest control professional etc.).
 - Identified underlying physical risk issues should be itemized as individual Priority Repairs
 - Multiple repairs should not be aggregated into one repair.
 - “Cost to cure” in Priority Repair should generally represent the cost to remediate the underlying issue, not cost to research or clear the violation with the city.
 - If an administrative-based violation is unresolved and requires special attention, it can be noted as an individual Priority Repair.
- ✓ **1104 code violation summary comments** (see examples below)
 - Does not directly translate to required repairs or Loan Agreement
 - No open-ended questions, unless follow-up by a specific professional is recommended
 - The following language should be avoided – “violations should be investigated and resolved”. Investigation of the violations is within the scope of Risk Engineer’s engagement
 - The list of outstanding underlying issues should be summarized into a concise narrative.
 - Copy/paste of disordered and unedited violations language directly from municipal agency websites should be avoided.

Underwriting and legal risk and mitigation considerations

- Consider the risk to the transaction and if this reflects the sponsorship’s management weakness and presents on-going occupancy/income collection risk, even if underlying physical risk issues have been resolved.
 - **Mitigation considerations:**
 - **Size of building** (2-3 violations in NYC per unit is benchmark of concern)
 - Larger buildings may have more gross violations, focus on per unit
 - **Nature of violations**
 - Most cities/municipalities have designations for varying degrees of violation severity—tenant-reported leaky sinks should reflect sponsor/management differently than imminent life safety concerns
 - **Acquisition or recently acquired?**
 - Sponsor history/success with improving properties with code violations
 - Declining violations since owned?
 - **Tenant/sponsor/management relationship**
 - If large number of tenant reported violations from various units, are violations a reflection of poor management and tenant relationship?
- Underlying issues are addressed through standard Priority Repair language based on standard best efforts based on loss and damages recourse carveout
 - As with all Priority Repairs, no deadline applies (i.e., within one year is N/A).
- SBL Loan Agreement does not have specific code violation section
 - Mitigation for resolving all non-repair identified code violations are subject to Section 5.07 of the Loan Agreement “Compliance with Applicable Laws and Regulations.”

Template narrative for code violations risk in Investment Brief:

Recently Acquired Property/Refi

Per Physical Risk Report, the subject has 20 open New York City Housing Preservation and Development (aka. "HPD") building code violations. Of these open violations, only 2 were deemed by the Engineer to have an open physical risk issue. The remediation of the underlying issues of defective window guard and self-door closing is required as a repair obligation in the Loan Agreement without escrow at a cost of \$5,000.

The NYC HPD violations include 1 "A Class", 3 "B-Class", and 16 "C-Class" violations that are dated between 1998 and 2016. Less than 10 % of the violations occurred during the sponsor's ownership between 2015 and 2016. Of all the open violations, a majority were tenant reported not deemed imminent life safety concern.

Representative violations include repair water leaks, repair valve at radiator, make self-closing doors, repair defective window guard, etc. The sponsor successfully lowered the total number of violations under their ownership from 44 to 20, and current outstanding violations are not deemed a material negative reflection on the sponsorship or management.

Under the "Compliance with Applicable Laws and Regulations" section of the Loan Agreement, the sponsor is generally required to remediate all property code violations, irrespective of the those specifically named as a Priority Repair.

Examples of inappropriate code violation summary comments in Form 1104:

Inconclusive

Description of violation	Underlying physical issue resolved?	Cost to Cure
Information obtained from the NYC DOB website indicated that there are five open NYC DOB violations associated with the Property. Arranged by Category the violations consist of the following: four elevator and one energy bench-marking. The violations are dated between 2012-2017. NYC DOB issue violations for failure to file benchmarking report of energy use as per Ad. Code Sec. 28-309.4. The open NYC DOB violations should be investigated and resolved.	No	\$1,000.00

Disorganized

Description of violation	Underlying physical issue resolved?	Cost to Cure
Information obtained from the NYC HPD website indicated that there are 20 open violations associated with the Property. Arranged by category, the violations consist of the following: three "A-Class," 14 "B-Class" and three "C-Class" violations that are dated between 2012-2016. Thirteen of the violations are dated between 2015-2016. These violations include peeling paint, abate mice, abate roaches, abate mold, repair broken lock, repair water leak, replace missing smoke and carbon monoxide detectors, abate bedbugs. Costs to cure these are included.	No	\$2,800.00

Unclear

Location or Unit #	Basement	Violation on record?	Yes
Description of violation and/or observed concerns			
HPD Violations (2008) - discontinue use of rooms for living, disconnect plumbing fixtures and properly seal pipe connections at west cellar; file plans and application and legalize the following alteration or restore to the legal condition existing prior to the making of said alteration erecting walls creating rooms for living at west cellar; discontinue unlawful cooking space or file plans and application with this department to legalize same, if lawfully feasible, at west cellar			