

CAPITAL NEEDS ASSESSMENTS AND RESERVE ANALYSIS GUIDELINES

Maryland Department of Housing and Community Development

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I. Purpose and Background

The purpose of these guidelines (these “**Guidelines**”) is to provide project borrowers/owners and management agents (collectively “**Owners**”) of rental projects (“**Project**” or “**project**”) with loans (including repayable grants) made by the Department of Housing and Community Development (“**DHCD**”) and the Community Development Administration (“**CDA**” and, together with DHCD, the “**Department**”) with guidance on Department requirements for Owners to obtain and provide the Department with Capital Needs Assessments in connection with standard servicing and asset management requests.

The Department has interests in this subject both due to its public purpose to ensure the quality and affordability of developments over the entire life of its loans and regulatory agreements and in its role as a lender with a collateral security interest in project property, reserves and escrow accounts. Additionally, the Department performs a compliance monitoring role in connection with certain Federal programs (i.e. tax credits).

The Department seeks to ensure that Owners and the Department are periodically assessing the capital needs of properties funded by the Department and ensuring that reserves are sufficient, at all times, in order to meet the current and future anticipated capital needs of projects, while also not being over-funded such that capital is not available to pay project obligations.

II. Definitions & Requirements

“Capital Expense” or **“Capital Item”** - consist of major capital improvements to the physical plant of a property and its systems that significantly increase their value and/or useful life. Unless otherwise defined in the Loan Documents, a Capital Expense or Capital Item is generally considered to be an item that has a useful life of more than 1 year - or extends the existing useful life of an existing Capital Item by more than 5 years. Costs and expenses typically considered as administrative (finance and staffing), maintenance (regular and recurring expenses associated with maintaining the physical integrity and upkeep of the property) or turnover expenses (costs of painting, cleaning, unit prep) are not typically considered Capital Expenses or Capital Items.

“Capital Needs Assessment” or **“CNA”** is a comprehensive property inspection and report that estimates future maintenance and repair costs over a specified period (typically 20 years) by evaluating the current physical condition of a property and its systems. For purposes of these Guidelines, the Department will accept any form or format of assessment or report¹, provided it meets the Department's minimum requirements as set forth in these Guidelines.

“Self-Assessment CNA Report” a report prepared by the Owner or Owner’s agent evaluating the current physical condition of a property and its systems and estimating the future maintenance and repair costs over a specified period – not less than seven (7) years.

“CNA Provider” means an entity conducting and submitting a CNA and/or CNA report to, for or on behalf of an Owner, including their personnel and subcontractors.

¹ Different entities have certain pre-approved and required forms and formats for conducting capital needs and property condition assessments - e.g. Property Condition Needs Assessment (PCNA); Property Condition Assessment (PCA); Property Condition Report (PCR); Physical Needs Assessment (PNA); Multifamily Property Condition Assessment (MPCA).

“Estimated Useful Life” or **“EUL”** is the average Estimated Useful Life for the specified system/component, as set forth in the EUL Tables published by Fannie Mae - Form 4099.F published August 2019 - which can be downloaded from its website - [4099f.pdf](#). To the extent a component is not listed in the Form 4099 F, the item should be assigned to the most closely related category.

“Effective Age” is the approximated age of the specified system or component based on the CNA consultant’s assessment of the actual age and condition of the system or component.

“Loan Documents” refers to agreements, instruments, certificates or other documents evidencing, securing or otherwise relating to financing provided by the Department.

“Remaining Useful Life” or **“RUL”** is the expected remaining useful life of the specified system or component before it is functionally obsolete or in need of replacement based on the EUL minus the Effective Age.

“Third Party CNA Report” is a report prepared by a professional CNA Provider and meets the requirements imposed by these Guidelines.

III. Scope and Applicability

The Division of Credit Assurance (**“DCA”**) of the Department is responsible for all asset management activities relating to Department funded loans, including:

1. physical inspections;
2. fiscal analysis of financial operations and compliance with loan covenants;
3. monitoring the sufficiency of RfR accounts; and
4. evaluation, processing, and approval of all reserve and escrow disbursement requests.

The Loan Documents typically provide minimum requirements relating to

- the maintenance of the physical condition of the project; and
- the establishment of reserve and escrow accounts.

Most multifamily projects are also subject to the Department’s Multifamily Rental Financing Guide which sets forth certain minimum development quality threshold requirements some of which include energy efficiency maintenance requirements. The Department may also issue separate guidance regarding the eligibility of projects for various asset management requests and matters that the Department considers in analyzing such requests.

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These Guidelines are meant to supplement and provide clarity and consistency around the Department's requirements for obtaining and submitting CNAs, both in the course of ordinary loan servicing/monitoring and to be used in connection with asset management requests and decisions. In the event that the Loan Documents directly conflict with the requirements of these Guidelines, the Department will apply these Guidelines in accordance with the terms of its agreements in a way that, in the discretion of the Department, most closely parallels these Guidelines.

CNAs and evaluations may be required by other entities with interests in the Owner or their property (e.g. HUD, RD, other lenders, partners, investors, etc.). These entities may have different requirements or may require the Owner to submit additional or different information and documents. These Guidelines contain solely the requirements of the Department. In addition, CDA may require additional or different information and documents in connection with its underwriting requirements and in its roles as a tax credit compliance monitor and Section 8 administrator.

Prior to obtaining a CNA, Owners should review these Guidelines, their Loan Documents, the requirements of other project financing documents, partnership or operating agreement, management agreement, budget, current reserve balances and funding levels, and the Project's capital improvement schedule, and the most recent capital needs analysis.

IV. CNA Requirements & Guidelines

A. Form and Substance of Reports

Self-Assessment CNA Reports

Self-Assessment CNA Reports must include the following minimum components:

1. Inventory of Capital Items and Systems. The inventory component must include all of the building systems, not just those that may require attention during the report period. The inventory must include the Effective Age of each Capital Item and building system. Any item that has recently been replaced, and may not be expected to need attention again for the remainder of the reporting period, should still be listed for reference. If the assessor has made an assumption that a particular item represents an operating cost concern, the analysis should be shown to facilitate discussion and remediation. Each system or item included must have its age identified. In older properties, ages of components may not coincide with the development's age. Ages may vary widely between items and even across a single item.
2. EUL Estimates. EUL estimates are the key to replacement timing. EULs should be adjusted from the norms found in various tables to the actual conditions at each development. EULs should be adjusted for climate, original materials and installation,

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maintenance practices, and resident demographic profiles. For example, elderly and family occupancy present different issues.

3. Critical Repair Items. All health and safety deficiencies or violations of the Department's applicable inspection standards, including any/all Federal lead based paint requirements, and the Department's Loan Documents that require immediate remediation.
4. Immediate-Term (0-2 Years) Physical Needs. An estimate of the repairs, replacements and significant deferred and other maintenance items that will need to be addressed within 2 years, including Critical Repair Items, and including cost estimates.
5. Short-Term (2-6 Years) Physical Needs. An estimate of the repairs, replacements, and significant deferred and other maintenance items that will need to be addressed within 2 to 6 years. Includes the minimum market amenities needed to restore the property to the standard adequate for the rental market for which the development was originally approved. If the standard has changed over time, the rehabilitation may include improvements to meet the current standards.
6. Medium-Term (7 +Years) Physical Needs. An estimate of the repairs and replacement items beyond the first year that are required to maintain the development's physical integrity over the next 7-year period (or longer), such as major structural systems that will need to be replaced during this period.
7. Cost Estimates. Cost estimates for the amounts anticipated to be incurred for the required repairs/replacements. Cost estimates should take into account replacement costs adjusted for the local area. The ability to adjust costs for individual building circumstances and the relative purchasing power of the developer/owner/manager may be taken into account. A detailed year-by-year cost summary of all of the anticipated capital needs should list the amount and timing of expenditures.
8. Actual and Budgeted Repairs/Replacements. For each category/item, total amounts paid for repairs/replacements in the prior fiscal year, any amounts budgeted for repairs/replacements during the current calendar year.

Owners may (a) use their own forms and templates for Self-Assessment CNA Reports, provided that they include the minimum requirements imposed by these Guidelines, or (b) utilize the Department's Form 7 Year Capital Needs Self-Assessment CNA Report 7 Year Capital Needs Self-Assessment Report.

Third Party CNA Reports

A Third-Party CNA Report must meet the requirements of a Self-Assessment CNA Report and include the following additional components:

9. Medium-Term (7-12 Years) Physical Needs. An estimate of the repairs and replacement items beyond the first year that are required to maintain the development's physical integrity over the next 7 - 12-year period, such as major structural systems that will need to be replaced during this period.

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10. Long-Term (12 - 20 Years) Physical Needs. An estimate of the repairs and replacement items beyond the 12-year period that are required to maintain the development's physical integrity through twenty (20) years.
11. Analysis of Reserve for Replacement. An estimate of the initial and monthly deposit to the RfR account needed to fund the development's physical needs for the report period, the existing RfR balance, and the EUL of major building systems. This analysis shall include the cost of Critical Repair Items, Immediate-Term, Short-Term, Medium-Term and Long-Term physical needs, but not any work items that would be treated as operating expenses.

Narrative presentations should describe the current condition, maintenance history, and the rationale behind the consultant's cost and timing decisions; therefore, an Executive Summary is especially helpful and encouraged. Narratives allow for a description of the cause of current problems, details on location of problems, or discussion of alternatives like rebuilding a pump motor instead of replacing the whole pump.

Photographs are required and are an invaluable tool when the report has a non- technical audience or is shared with a third party. These readers may never have been in a boiler room or crawl space and may be unfamiliar with technical terms. Photographs can also support the findings and recommendations of the consultant. Showing the extent of the siding damage or the width of the foundation cracks can overcome a lot of resistance.

Substitute CNA Submissions

The Department will generally accept CNAs performed in accordance with the requirements by other lenders or subsidy providers (e.g. HUD, USDA, Freddie Mac, FNMA) to the extent that the CNA is performed in accordance with the requirements of that entity's written guidelines and requirements and is substantially similar to the requirements set forth in this Policy.

B. Frequency and Timing of Submissions

The Department requires the regular submission of CNAs for purposes of monitoring the physical condition of projects and determining appropriate reserve balances. CNAs are to be submitted to the Department via the Project's Procorem WorkCenter - 02 Routine Project

Monitoring / 06 Property Condition and Capital Needs folder - along with all required supporting documents.

Self-Assessment CNA Reports

Each year, beginning with the first full year following substantial completion of the Project, the Owner will be required to conduct and submit to the Department an analysis of the Project's physical and capital needs and submit a Self-Assessment CNA Report in a form acceptable to the Department analyzing the anticipated capital needs of the Project over the next 7+ year period. Self-Assessment CNA Reports are due to the Department by the end of the Project's fiscal year, along with the Property's annual budget.

Third-Party CNA Reports

The Department currently does not require Third Party CNA Reports to be provided at any set interval. Third Party CNA Reports may be required or requested by the Department on a case-by-case basis dependent upon a variety of factors including, but not limited to,

- Self-Assessment CNA Reports, or similar assessments or reports received by the Department, on the Project's current and future capital needs;
- Project capital and operating budgets;
- The Project's financial and operating history;
- The condition of the Project and its systems based on the observations of the Department inspectors;
- The balance of the RfR and other reserves and accounts available for payment of capital needs;
- Experience with comparable projects; and/or
- Additional information supplied by the Project, including any approved or committed sources of funding or contributions for payment of capital needs.

The Department may also require submission of a Third-Party CNA Reports for purposes of analyzing and considering asset management requests. A Third-Party CNA Report generally should not be older than 2 years from the date of submission of an asset management request

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for which a Third-Party CNA Report is required by the Department. If closing on the transaction takes place more than 2 years from the date of the Third-Party CNA Report, the Department may require a new or updated Third Party CNA Report. If the existing Third-Party CNA Report on file meets the Department's requirements, the Department will not require an additional Third-Party CNA Report.

The above CNA schedules should be viewed as the minimum expectation for Projects and Owners. The Department reserves the right to require the preparation and submission of more frequent CNAs, and nothing herein shall be construed as limiting that right.

Exceptions/Waivers to Requirements for Small and Special Loan Projects

Projects with less than 20 units and/or scattered site projects consisting of multiple individual dwelling unit structures located on non-contiguous parcels of land may receive waivers from the standard CNA requirements at the discretion of the Department, including but not limited to:

- extensions to the frequency of CNA submission requirements; and
- alternative inspection forms and formats.

Waivers should be requested at least 1 year in advance of the Project's deadline to submit a CNA.

C. Requirements of CNA Providers

CNA Providers:

- must be independent third-parties, unrelated to, and not have any financial or economic interest in the property, Project or Owner.
- may not be an affiliated entity of the Owner unless disclosed to and approved by the Department in advance.

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- may not be under suspension or debarment by HUD of the State of Maryland or involved as a defendant in criminal or civil action with HUD or the State of Maryland.

CNA Providers should meet the following minimum requirements for qualifications, professional education, training and experience to perform site visits and prepare CNA reports:

- required knowledge, experience, licenses and certifications authorizing them to perform CNA and CNA reports in accordance with applicable law and industry standards;
- 5+ years of professional experience in one or more of the following disciplines:

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- Architecture;
 - Engineering (structural, mechanical or civil); or
 - Construction management and cost estimating (which may include cost estimating experience associated with the preparation of a CNA Report). 3+ years of experience performing multifamily property condition physical needs assessments, completed a minimum of five property inspections, and reporting of property condition assessment findings in a manner consistent with these Guidelines or ASTM E2018-24 “Standard Guide for Property Condition Assessments: Baseline Property Condition Assessment Process” (as updated); or
 - Knowledge and experience with ASTM E2018-24 (as updated); or
 - possess or have completed one of the following programs:
 - Bachelor of Science degree in engineering, architecture, construction management, historic preservation, construction/building science or building facilities management.
 - Property Inspection Risk Management course offered by the MBA;
 - Real Estate Assessment Center (“**REAC**”) for the Department of Housing and Urban Development (“**HUD**”) as a NSPIRE Inspector;
 - Building Performance Institute (BPI);
 - 5+ years assessing multifamily properties and preparation of ASTM E2018-08 compliant reports.

D. Adjustment to RfR Deposits

The Department will review CNAs and consider them in connection with its determination as to any “Capital Needs Shortfall”, as defined in the Department’s Reserve for

Replacements Maintenance and Request Guidelines (the “**RFR Guidelines**”), and the sufficiency of existing RfR accounts and deposits.

The Department may require adjustments to the required RfR deposits in order to provide greater assurances that there will be sufficient funds to meet anticipated Project capital needs through loan maturity and affordability periods, as described in the RFR Guidelines.

E. Failure to Submit/Comply

Failure to comply with the Guidelines and/or the Loan Documents may result in the limitation, delay and/or denial of asset management requests, including requests for release of reserves that require a CNA. In certain circumstances, failure to comply with these Guidelines may constitute an event of default under the terms of the Loan Documents for which the Department may exercise available rights and remedies.

F. Waivers and Modifications

Projects may request temporary waivers or deferrals from these Guidelines based upon undue hardship or other special circumstances as determined by the Department.

The Department reserves the right to approve or reject any waiver requests in its sole and absolute discretion. Any waivers must be documented in writing and approved by the Director of DCA.

The Department reserves the right, in its sole and absolute discretion, to modify the requirements and process set forth in these Guidelines, or to waive or require different requirements, in accordance with its rights under the Loan Documents and at law; provided that such modifications and changes will not be applied retroactively and the Department will seek to provide reasonable notice of any material changes to these Guidelines in advance of enacting them.