

# RESERVES FOR REPLACEMENTS MAINTENANCE AND DISBURSEMENT 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/or the Community Development Administration (“**CDA**”) and, together with DHCD, the “**Department**”) with criteria for determining eligible expenses and evaluating, preparing and submitting Reserve for Replacement (“**RfR**”) withdrawal requests.

The RfR account is generally used to fund the replacement of major building components considered to be capital items, as well as certain major repairs. It is generally not intended for repairs or replacement of items that would be considered routine in nature.

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. The Department seeks to ensure that reserves are sufficient, at all times, in order to meet the current and future anticipated capital needs of projects. Alternatively, the Department also aims to ensure that reserves are not over-funded, which can impact the availability of capital to pay other project obligations.

To preserve the availability of funds for capital improvements and more costly repair items, the Department expects small, regularly occurring repair items to be accounted for in the Project’s operating budget and paid for with funds in the operating account.

## **II. 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. monitoring the sufficiency of RfR accounts; and
2. evaluation, processing, and approval of all RfR disbursement requests.

The Department’s loan documents, regulatory agreements, and other agreements executed in connection with loan funding (collectively, the “**Loan Documents**”) typically provide minimum requirements relating to the establishment of RfR accounts and disbursement of funds from RfR accounts. These Guidelines are meant to supplement and provide clarity and consistency around the Department’s decisions regarding the establishment, maintenance and use of funds in RfR accounts not specifically dictated by the Loan Documents. In the event that the Department’s 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.

Unless otherwise provided in the Loan Documents or these Guidelines, Owners must obtain written approval from DCA for any disbursements from the RfR. Owners may also be required to obtain consent of additional parties (e.g. HUD, other lenders, partners, etc.) prior to receiving or using RfR funds. These parties 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.

Prior to considering the use of funds in the RfR account, 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, the Project’s capital improvement schedule, and the most recent capital needs analysis.

For projects where the Department holds the RfR account and/or serves as a senior lender and/or servicer of record, the Department will have greater authority and responsibility for managing RfR. For projects where the Department does not hold the RfR and serves as subordinate lender only, or where CDA is a bond issuer for a senior loan that is not serviced by the Department, the guidelines applicable to RfR or other similar reserves may also be subject to the requirements of senior lenders and servicers. However, even in circumstances where the Department is not holding the RfR, in most cases, Owners must also seek the Department’s consent prior to seeking a disbursement of RfR funds.

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### **III. Eligible and Ineligible Expenses**

Building and site components generally tend to fall into two categories:

- 1.) Items that are usually considered to be Capital Items (as defined below) and are generally eligible for reimbursement from the RfR account; and
- 2.) Items that are usually considered routine maintenance and are generally not eligible for reimbursement from the RfR account, including items that are regularly replaced or repaired when turning over a unit.

The RfR account is a source of funding to repair or replace eligible Capital Items and, in some circumstances, may be a source for Unusual or Unanticipated Expenditures (as defined below). The account is not intended to cover routine and preventative maintenance or repairs or Non-Capital Items, except as set forth in these Guidelines.

#### **A. Capital Items & Unusual or Unanticipated Expenditures**

##### Capital Items

“**Capital Items**”, unless otherwise defined in the Loan Documents, are generally considered to be items that have a useful life of more than 1 year - or extend the existing useful life of existing Capital Items by more than 5 years.

“**Non-Capital Items**” are any items other than Capital Items.

A list of common Capital Items that are eligible for funding from the RfR, and Non-Capital Items that are not eligible, are included on the attached [SCHEDULE - Reserve for Replacement Eligible & Ineligible Expenditures](#). Owners should contact their DCA Project Manager or Portfolio Administrator for guidance on qualifying expenditures prior to submitting a request for disbursement from the RfR account.

Repairs and replacements paid for from a Project’s RfR should be planned for and scheduled by the Owner as part of regular Project financial planning/budgeting and Capital Item needs planning.

##### Unusual or Unanticipated Expenditures

The Department’s Loan Documents typically require an Owner to repay any sums paid out of or applied from the RfR account for (a) unusual or unanticipated replacement expenditures or (b) payments for performance of any other covenants under the Loan Documents, within a set period of time - typically 20 days - from the date requested by the Department.

**“Unusual or Unanticipated Expenditures”** include:

1. Capital Items purchased during the first 3 years following substantial completion of the Project;
2. Repairs and replacements for Capital Items which would, if paid or reimbursed from the RfR, would deplete the remaining balance in the RfR below the Minimum Required RfR Balance; and
3. Non-Capital Items required to comply with new federal, state or local regulations or requirements that were not reasonably anticipated at the time the loan was made (**“Non-Capital Regulatory Compliance Expenditures”**).

The Department may, in certain circumstances, (a) approve the use of RfR funds for Unusual or Unanticipated Expenditures and (b) waive or modify the requirement for repayment/replenishment of the RfR as required by the terms of the Loan Documents, if requested and approved in advance by the Owner.

#### **B. Maintenance of Minimum Required RfR Balance; Capital Needs Shortfalls**

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The **“Minimum Required RfR Balance”** is the the greater of:

1. The minimum amount required by the terms of the Loan Documents (if any);
2. For projects that are 36 months or more from their initial closing date, an amount equal to the sum of thirty-six (36) months of RfR deposits (in amounts required by the Loan Documents); and
3. The existing balance of the RfR account plus any “Capital Needs Shortfall” (as defined below) determined by the Department.

A Project will be considered by the Department to have a **“Capital Needs Shortfall”** if, in the determination of the Department, the exiting balance of the RfR, together with anticipated (a) periodic deposits to the RfR required by the Loan Documents, and (b) operating cash flow, are (or will be) insufficient to pay for the anticipated Project capital needs and repairs necessary in order to maintain the Project in a safe, sanitary and habitable condition, suitable for occupancy and in compliance with the Department’s Loan Documents, over the remainder of the term of the Department’s Loan Documents.

This determination will be made by the Department based upon:

- The balance of the RfR and other reserves and accounts available for payment of capital needs;
- Project capital and operating budgets;

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- CNAs, or similar assessments or reports acceptable to the Department, on the Project's current and future capital needs;
- The Project's financial and operating history;
- The condition of the Project and its systems based on the observations of the Department inspectors;
- 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.

In the event that the Department determines that the Project has a Capital Needs Shortfall, the Department may:

1. require the Project to temporarily or permanently increase the amount or frequency of periodic deposits into the RfR; and/or
2. deny or limit the amounts of any RfR disbursement requests that would take the balance of the RfR account below the Minimum Required RfR Balance.

### **C. Defaulted, Delinquent or Non-Compliant Projects**

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Unless otherwise approved by the Department, Projects that are in default, or are delinquent in payments to the Department or accounts required by the Department, are not eligible for RfR disbursements other than those made by the Department as protective advances pursuant to the terms of the Loan Documents or pursuant to the terms of a workout agreement or plan of action.

#### **IV. Advance Approval for RfR Eligibility; Requests for Advances from RfR for Capital Improvement Projects**

##### **A. Expenditures Requiring Advanced Approval**

The following expenditures require advanced approval from the Department in order to be eligible for reimbursement from the RfR:

1. Unusual or Unanticipated Expenditures;
2. Planned Improvement Projects over \$75,000 - Expenditures that are part of a planned improvement project involving investment in structural modifications/additions, accessibility, building envelope, or restoration costing in excess of \$75,000, in aggregate. This approval is expected to be obtained in advance of project initiation to avoid unnecessary inspections or costly changes that may be required to ensure regulatory requirements are met; and/or
3. Affiliate Payments - Expenditures for items of services purchased by, acquired from, or provided by an affiliate of the Owner. Requests for approval of expenditures to affiliates of the Owner must include two additional bids or estimates from non-affiliates, unless otherwise approved by a DCA Portfolio Administrator.

RfR Requests containing expenditures which required advanced approval will not be approved if advanced approval was not obtained prior to the work being completed, barring exceptional circumstances.

##### **B. Process and Procedure for Requesting Advance Approval for RfR Eligibility**

Requests for advanced approval of expenditures are made by submitting a written [Request for Advance Approval] to the Project's Procurement WorkCenter in the 03 Standard Requests / 01 Reserve, Escrow and Impound Disbursements/Approvals / 01 Reserve for Replacement Disbursements folder, along with required supporting documents based on the Request Type.

The Department will provide approval/denial, along with any required terms and conditions related to future disbursements, in the Project's Procurement WorkCenter.

Requests for advance approval of RfR eligibility must include the following information:

1. Reason for Submission (e.g. type of Unusual or Unanticipated Expenditure; Planned Improvement Project; Affiliate Payments; Other);
2. Description of Work/Services to be Performed or Equipment/Materials Purchased
3. Building Address(es) & Unit No(s).
4. Vendor/Supplier Name(s)

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5. Estimates or contracts;
6. The reason/justification for the exception from the standard RfR requirements, if any;
7. If the Request would result in the remaining balance in the RfR falling below the Minimum Required RfR Balance, the Owner's plan and proposal to return the balance to the Minimum Required RfR Balance, including explanation of sources and timeline.

### **C. Requests for Advances from RfR for Planned Improvement Projects Over \$75,000**

Disbursements from an RfR account are typically made as a reimbursement of previously expended funds.

The Department will consider requests from Owners to fund major capital improvements directly from the RfR account if funding of the improvements from the Project's operating account would severely restrict the Project's operating cash flow. The Department may make advances or make direct payments to vendors at its discretion.

Prior to requesting advance payments, Owners must submit the proposed contract and draw schedule to the Department. Requests for progress payments must be presented with a signed certification, in a form acceptable to the Department, evidencing that the applicable percentage of work has been completed or that materials have been purchased in accordance with the contract documents. In addition, all change orders will require the Department's approval.

In cases where a contract requires a deposit for materials or for project start up prior to the commencement of work, the Department will consider advancing the deposit from the RfR account. Such a deposit however will be limited to the value of the materials or the value of the labor to be used in the work.

### **D. Insurance Losses and Claims**

In the event that the Loan Documents provide the Department with the right to control or approve the use of insurance proceeds upon the occurrence of a loss or damage to the Project, and the Department approves advances from the RfR to be utilized for payment of expenditures for restoration of the damage caused by the loss event until such time as insurance proceeds are received, the proceeds must be used to replenish the RfR for the full amount of the advance(s) from the RfR account unless the Department provides written approval for another use and application of the proceeds.

## **V. Process and Procedure for Requesting RfR Disbursements**

Owners should periodically analyze the balance in their RfR account and consider the Project's anticipated capital needs, based on their knowledge of the physical condition of the

development, anticipated availability of operating revenues to cover capital needs based on their operating budget, evaluations made by their agents, underwriting requirements and the results of applicable physical inspection reports and capital needs studies.

#### **A. Timing and Frequency of RfR Requests**

1. Owners may not submit more than one RfR request each calendar quarter. Requests may be processed on a more frequent basis, at the discretion of the Department, to assist financially troubled projects, as phase payments for large capital improvement contracts, and/or because of other circumstances deemed appropriate by the Department.
2. Owners are encouraged to submit RfR requests on a quarterly or semi-annual basis. Owners are discouraged from submitting a single annual disbursement request.
3. Expenditures incurred more than 1 year prior to the date of the request are generally not eligible for reimbursement from the RFR absent exceptional circumstances. As such, requests should be submitted within 1 year from the date of the oldest item contained in the Request.

#### **B. Preparation of Complete RfR Package**

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An RfR request and all supporting documentation must be complete, prepared and submitted in compliance with these Guidelines in order to be eligible for review by the Department.

##### **1. Analyze and Prepare Submission Package**

##### **Step 1 - Review Guidelines and Eligible/Ineligible Expenses Schedules**

Review the Loan Documents, these Guidelines and the [\[SCHEDULE - Reserve for Replacement Eligible & Ineligible Expenditures\]](#) to ensure that:

- No other RfR request has been submitted during the current calendar quarter;
- The RfR request includes only items for reimbursement (or advance) that were (will be) incurred and paid for during the current (or prior) fiscal year.
- The project has obtained and submitted any required CNA that is on file with and acceptable to the Department in accordance with the Department's requirements, if required;

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- No items are Unusual or Unanticipated Expenditures (unless advanced written approval was obtained);
- The total RfR request, if approved, will not deplete the RfR account below the Minimum Required RfR Balance (unless advanced written approval was obtained);
- All items in the RfR request have been completed/delivered and paid for (unless the RfR request is being submitted for advance payment - see Section IV Advance Approval for RfR Eligibility);
- All items in the Request are supported by invoices/contracts that comply with the below requirements.

### **Step 2 - Complete RfR Request Form and Worksheet**

- Cover Sheet
  - Project Information
  - Payee Information
  - Routing/Wire Instructions
- Request Form
  - Request Date
  - Last Approved Request Date
  - Total Amount Requested
  - Completed Questionnaire
  - Signed Confirmation and Certification
- Worksheet
  - For each Service/Item submitted
    - Building Address & Unit No.
    - Description of Work/Services Performed or Equipment/Materials Purchased
    - Vendor/Supplier Name
    - Invoice Number
    - Invoice Date
    - Date Work/Services Performed or Equipment/Materials Delivered
    - Invoiced Amount for Work/Services Performed or Equipment/Materials Delivered
    - Payment Ref (Check or Wire #)
    - Payment Amount
    - Date Payment Made

### **Step 3 - Attach Supporting Documentation**

All items identified in the RfR Request Form must be supported by appropriate invoices and backup documentation demonstrating that the work/services and/or materials/equipment were (a) completed/delivered, and (b) paid for.

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All supporting documentation must be saved with a number at the beginning of its file name corresponding to the Item Number on the RfR Worksheet.

- RfR Account Bank Statement - Current (within 7 days of RfR Request date)
- Prior Approval (if applicable) - all items that required prior approval must be supported by written documentation of DCA approval
- Invoices - must contain
  - Invoice Number (must match Worksheet)
  - Invoice Date
  - Project Name or Project Owner name
  - Description of Work/Services or Equipment/Materials purchased
  - Quantity
  - Building Address(es) (for any building specific services, equipment or materials)
  - Unit No(s) (for any unit specific services, equipment or materials)
  - Amount Charged
- Payment Records -
  - Check number/account statement, amount(s) and date(s) paid must match the amount(s) indicated on worksheet.

### **C. Submission, Processing, Approval and Reimbursement from RfR**

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All RfR requests must be submitted to the Project's Procorem workcenter - 03 Standard Requests / 01 Reserve, Escrow and Impound Disbursements/Approvals / 01 Reserve for Replacement Disbursements folder - along with all invoices, contracts, statements, payment records and other required supporting documents.

To avoid delays, the Department recommends the submission of quarterly or semi-annual requests rather than one large request at the end of the fiscal year.

DCA will review and respond to all RfR requests within 15 calendar days of submission, and strives to have all RfR requests processed within 30 days of submission of a complete request.

If the RfR disbursement request does not contain the required information or supporting documentation, it will be returned to the Owner with a request for additional information and identifying the reasons that the submission or specific items are missing or incomplete. A new 15-day approval period will begin when all required information is received by the Department.

Project's will have at least 15 days from notification of deficiency to correct and/or submit the missing information and documents. If all of the additional required information/documentation

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is not submitted by the Project within the required time period, the Department may process the RfR Request, as submitted, and deny any items that are not supported by the submission or may deny or terminate the entire RfR Request, requiring the Project to submit a new request.

If approved, the Department will (a) notify the Owner and the Department's servicer of the approval and instruct the servicer to process payment in accordance with the payment instructions provided and approved, or (b) provide the Owner with written approval, if the funds are held by a servicer other than the Department's servicer.

### **D. Automatic Consent**

The Department's consent to release of funds from an RfR will be deemed given and approved automatically ("**Automatic Consent**") in certain limited circumstances set forth below.

#### Projects Eligible for Automatic Consent

Projects which meet all of the following criteria will be eligible for Automatic Consent:

1. The Department is not the senior lienholder of the RfR;
2. The Department does not hold the RfR;
3. The total outstanding debt owed to the Department is less than \$3.5 million (inclusive of accrued interest);
4. The funds being requested are not for reimbursement or payment of any Unusual or Unanticipated Expenditures;
5. The Owner (including any affiliates of the controlling members/partners and management company) is not in default and/or out of compliance with its obligations to the Department on the Project; and
6. The Department has not revoked the Project and/or the Owner's ability to obtain Automatic Consent.

#### Process for Obtaining Automatic Consent

For Projects eligible for Automatic Consent, the Department's consent is deemed provided on the date that the Project uploads the following documents into the Project's Procorem WorkCenter:

- Executed DHCD Reserve for Replacement Request - Automatic Consent Form & Certification; and
- Copies of the submission(s) to, and written approval(s) from, the senior lender/entity holding the RfR and tax credit investor (if any)

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- Unless already included within the documentation included in the senior lender/RfR holder approvals, copies of documents required by the Department to be submitted with standard RfR requests (e.g. invoices, payment records, etc.) in Section V.B of these Guidelines

### Revocation and Modification of Automatic Consent

The Department reserves the right, in its sole and absolute discretion, to modify the requirements and process for obtaining Automatic Consent under these Guidelines and/or to revoke the ability of any specific Project(s) or Owner(s) to obtain Automatic Consent at any time.

### **E. Waivers and Modifications**

Projects may request temporary waivers 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 or exceptions 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 to approvals and disbursements already completed and the Department will seek to provide reasonable notice of any material changes to these Guidelines in advance of enacting them.