OPERATING DEFICIT RESERVE (ODR) POLICY

Contents

Purpose of Operating Deficit Reserve

The Operating Deficit Reserve (ODR) account is primarily designed to supplement the development's cash flows based on projected operating deficits established during the underwriting process. The policy helps provide guidance regarding the setup, management, and disbursement of funds from the ODR account. If a development's Regulatory Agreement language conflicts with this policy, the Regulatory Agreement parameters supersede the policy parameters.

Contributions to ODR

When required, the Mortgagor shall establish an ODR with the Authority at or prior to the initial disbursement of loan proceeds in the amount designated by the Regulatory Agreement. The ODR shall be funded in cash and the funds in the ODR will be invested and reinvested by the Authority's Finance division. Interest earned, if any, shall become part of the ODR and shall be treated and disbursed in the same way.

For further details regarding the projected deficits, review the Operating Deficit Reserve cash flow analysis which is typically attached to the Regulatory Agreement or within the closing documents. During the mortgage term, the Authority may require a replenishment of funds by the owner if an analysis of the ODR balance projects insufficient funds to supplement operating deficits through the end of the mortgage. The analysis process and requirements are covered under "Reviewing ODR Funding Amounts".

ODR Schedules

An ODR schedule of deficit may be referenced as an attachment to the Regulatory Agreement, the ODR Agreement, or as a schedule attached to the loan commitment documents.

When reviewing the schedule, the primary row to review is the "Total 1.0 DCR and Maintained DCR". ***"Total 1.0 DCR and Maintained DCR"*** equals the projected amount of funds needed for a development to break even with a minimum maintained cash flow amount as required by the underwriting process and the designated maximum disbursement amount before the owner becomes **ineligible** to receive a limited dividend payment.

In some cases, the attached schedules display a "deficits" row that will be used to determine the designated maximum disbursement amount before the owner becomes ineligible to receive a limited dividend payment.

See attachment 505C – Sample ODR schedule for an example of the critical field to review on the current schedules used to identify projected deficits. The critical field is in a larger font size, bolded, and italicized.

Eligible Expenses

ODR funds may be used to pay for development operating expenses based on the priority set forth in the Management Agreement under Section 5 – Expense Management. Funds should not be used for items that were or will be reimbursed from other escrows accounts, such as replacement reserve items. Eligible expenses include:

- Payments to maintain the fiscal integrity of the development.
- Expenses/payables projected to come due without operating funds being available in the next 30 days.
- Payments to fund tax and insurance escrow shortages.

Requests for ODR Disbursement

The Owner/Agent may request either a budgeted monthly disbursement or a one-time withdrawal from the ODR account. Each development has a minimum appropriate level balance that should be maintained, which is based on the development's cash-flow calculations generated during underwriting. If the development overdraws the cumulative scheduled ODR draw amount, the development needs to restore the ODR account to the appropriate level for the Owner to become eligible for a limited dividend payment. The appropriate level requires the ODR account to be reimbursed for overdrawn ODR amounts equal to the total cumulative ODR draws scheduled as of

December 31st for each year. The *appropriate level* is calculated by the following equation:

Cumulative total of “Total 1.0 DCR and Maintained DCR” draw amounts through the current audited year end **minus** cumulative ODR draws taken from the ODR account as of December 31 of the current audited year **plus** any surplus cash or other funds previously deposited into the ODR account.

This equation is calculated from the scheduled ODR draws on the performas and must be carried forward to the current year to determine the *appropriate level* balance. Attachment 505C provides an example ODR draw schedule on a performa. If all the ODR draws (based on the “Total 1.0 DCR and Maintained DCR” amounts are taken as scheduled, the ODR balance declines to zero in the 20th year.

Budgeted Disbursements - When the Owner/Agent anticipates an operating deficit will occur during an upcoming year, the Owner/Agent may submit an ODR withdrawal amount on the Budget form #450 as part of the development’s annual budget submission process. Budgeted disbursements, approved as part of the annual budget process, are generally disbursed monthly and supplement the Mortgagor’s required payments (including mortgage principal, interest, and all escrow payments) to the Authority. If ODR funds in excess of the required payments are requested, a disbursement schedule must be approved by the Director of the Asset Management division to disburse the funds in excess of the payments designated on the “Total Annual Draw to achieve 1.0 DCR” line item of the cash flow analysis. No Limited Dividend payments can be budgeted if an ODR withdrawal is **budgeted** on a development’s annual budget form #450.

One Time Disbursements - The Owner/Agent may also make one-time disbursement requests from the ODR. ODR requests should be submitted to the assigned Asset Manager and include the:

- Operating Deficit Reserve Request (MSHDA Mgmt. 505A) form with an explanation of the intended use of the funds.
- ODR Draw Worksheet (MSHDA Mgmt. 505B) as evidence of the current cash position of the development.
- Request amount, which must exceed $1000.

Reviewing the ODR Funding Amounts

In a year designated by the Regulatory Agreement (i.e. 15th, 18th, or 20th year) or when the ODR becomes 80% depleted, whichever comes first, the Authority will analyze and update the amount of ODR funding. Based on this analysis of an updated Cash Flow Projection through the remainder of the extended use period or any Authority funded loan terms, the Authority may determine the ODR requires additional funding. The Mortgagor has 60 days from the additional funding request to deposit *non-operating* *cash* to the ODR account in the requested amount or become subject to a default on the loan obligation(s) to the Authority.

1. *Determining Amount Needed to Fund Future Projected Operating Deficits* – If the amount available in the ODR is not sufficient to fund projected operating deficits through the remainder of the extended use period or any Authority funded loan term, whichever is later, the assigned Asset Manager must update the Cash Flow Projections work sheet. Projections should be based on historical MIE data trends or the current Asset Management division portfolio trends in the development's region (e.g 1% annual income increase, 3% annual increase in expenses).

2. *Balance Remaining From Initial ODR Funding* – Any remaining portion of the ODR intended to cover the first 15, 18, or 20 years (depending on Regulatory Agreement) of Development operations will first be applied to fund the updated ODR balance projections for the remainder of the extended use period or Mortgage loan term, whichever is later.

   If the updated ODR schedule concludes excess funds exist in the ODR account, the excess funds may be eligible for release to the Development's Operating Reserve Cash account upon the request from the Mortgagor. The following criteria must be met for the development to qualify for a release of ODR funds to the Operating Reserve Cash (ORC) account:

   a. *Liquidity* – Review the past 12 month's trends in the development's operations. If the trends are different from the current operation's status, provide an explanation of the change with any release recommendation. For the 12 months preceding the date of evaluation, the operating liquidity position (excluding any owner contributions) has remained at or above one month's gross rent potential – **and** – the average physical vacancy equals 5% or less.

   b. *Mortgage Delinquency* - No mortgage delinquencies exist and payments have been current during the preceding 12 months through the date of the potential pending release of ODR.

   c. *Escrow Funding* - All escrow accounts, for example the Replacement Reserve and Tax and Insurance Escrow are fully funded. Consideration should be given to the ***projected*** funding levels for the replacement reserve for the life of all extended use periods and any Authority funded loan terms.

   d. *Non-IoI Payables* - All non-Identity of Interest undisputed payables are less than 60 days old.

   e. *IoI Payables* - No Identity of Interest vendors have been paid when there is any non-Identity of Interest accounts payables over 90 days unless an "Accounts Payable Action Plan" is approved by the Authority.

f. *Deferred Maintenance* - All deferred maintenance items listed on the most recent inspection or re-inspection report have been responded to appropriately.

g. *Fidelity Bond* - The Employee Dishonesty/Crime Coverage Policy is current.

h. *Annual Audit* - The annual certified audit has been reviewed, approved, and indicates that no material weaknesses exist in the operation that could jeopardize the development.

i. *Legal Liabilities* - No pending or threatened claims against the mortgagor or disputed payables exist that would materially affect the financial condition of the development as reported in the most recent monthly operating statement.

j. *Management Fee* - For the last 12 months preceding the evaluation date, the development has paid a management fee equal to or less than the maximum basic management fee allowed by the Authority – or – liquidity (excluding owner contributions) is greater than or equal to the **approved** management fee less the management fee actually paid.

k. *Satisfy Financial and Physical Obligations* – All financial (e.g. funding of escrows and reserves, timely submission of budgets and audits) and physical obligations to the Authority and Federal Government have been met (e.g., under all regulations, guidebooks and written agreements binding the owner or the development, such as loan documents, regulatory or use agreement(s), management agreement, subsidy contracts, etc.).

ODR and Surplus Cash

During the annual certified audit process, ODR funds withdrawn in excess of the cumulative scheduled ODR draw amounts are reviewed in relation to the scheduled ODR fund draws. If surplus funds exist, the overdrawn ODR funds must be reimbursed to the ODR account in an amount equal to the lesser of the ODR funds overdrawn or the amount of surplus funds available before determining the surplus funds available for distribution. See attachments 505D and 505E to learn more about how to manage various ODR events.

Mortgage Loan Prepayment

Upon payment in full of a development's mortgage loan, the release of funds in the ODR account is governed by the regulatory agreement and applicable laws.

Forms and Attachments

505A – Operating Deficit Reserve (ODR) Request
505B – ODR Draw Worksheet
505C – Sample ODR Schedule
505D – ODR Processing Scenarios
505E – Audit Schedule Example