

SSAM REPLACEMENT RESERVE (RR) POLICY

This policy provides guidance regarding the Replacement Reserve account and the distribution of funds from the account. The following topics will be covered:

Purpose of Replacement Reserve (RR)

Contributions to RR

RR Funding Levels

Eligible Expenses

Ineligible Expenses

Requests for RR Disbursement

Requests for Pre-Approval

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Purpose of Replacement Reserve (RR)

MSHDA's Regulatory Agreement requires the establishment and maintenance of a Replacement Reserve fund. The RR fund is primarily designed to defray the cost of the replacement of major depreciable items provided for in the original mortgage.

Contributions to RR

The initial deposit and funding to the RR designated in the Regulatory Agreement must be deposited at or prior to the closing of the Mortgage Loan. The required minimum annual ongoing funding is characteristically defined in detail within the Regulatory Agreement and is often expressed as:

- A percentage of the previous year's approved annual Gross Rent Potential (GRP);
- A flat dollar amount designated by the current finalized CNA (an updated CNA may be generated every five years);
- A flat dollar amount designated by the Regulatory Agreement;
- A percentage increase over the previous year's annual deposit; or
- The greater of a stated percentage increase over the previous year's approved Gross Rent Potential or a stated percentage increase over the previous year's deposit.

Any interest becomes part of the RR and is subject to the disbursement procedures described herein. The RR is an asset of the development and remains with the development upon any change in ownership for the term of the mortgage.

RR Funding Levels

The RR balance is anticipated to cover capital costs through the life of the mortgage. The following RR funding level categories address the current RR balance, future funding and anticipated capital costs through the life of the mortgage:

- Adequate Funding – In this status, contributions are being made according to a minimum recommended funding level described in the Regulatory Agreement.
 - Under funding – This status occurs when the contributions to the RR do not meet the levels recommended by the Regulatory Agreement.
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RR Needs - Developments with RR Needs amounts must resolve the RR Needs amount before limited dividend payments can be disbursed. At the end of each fiscal year, a review of the RR activity occurs to determine what the updated amount of the RR Needs actually equals as of the end of the fiscal year.

Eligible Expenses

An item(s) may be eligible to receive reimbursement for replacement, if the:

- RR Worksheet indicates that adequate funding is available;
- Item has exhausted its normal or useful life expectancy;
- Cost for replacement item(s) is reasonable;
- Installation meets the minimum FHA and MSHDA Design Standards;
- Development has been in operation for five years (*the 5 years starts on the first of the month following closing*) unless the replacement is the result of an emergency need; and
- Item is identified on the list below:
 - Antennas;
 - Appliances (Stove, Refrigerator, Washer/Dryer, Dishwasher, Range Hood, and Microwave);
 - Asphalt;
 - Bathroom Fixtures (Vanity, Tub, Toilet, and Medicine Cabinet);
 - Boiler and “Major” Components – See the ineligible expenses section for examples of non-major components;
 - Cabinets;
 - Carpet (including labor to move furniture and appliances when installing the flooring);
 - Carports;
 - Common Area Furnishings;
 - Chimney;
 - Concrete;
 - Counter Tops;
 - Doors and Hardware;
 - Eaves Troughs;
 - Elevator Parts;
 - Emergency, Fire Protection, and Security Equipment;

- Exercise Equipment;
- Exhaust Fans;
- Faucets;
- Fences;
- Garbage Disposals;
- Handrails;
- HVAC System and “**Major**” Components – See the ineligible expenses section for examples of non-major components;
- Light Fixtures;
- Painting – Exterior and Common Areas;
- Playground Equipment;

- Repaving;
- Roofing;
- Siding;
- Development and Building Signs;
- Sinks;
- Smoke Detectors;
- Swimming Pool Repairs;
- Tile/Linoleum/Sub Floors (including labor to move furniture and appliances when installing the flooring);
- Trees and Foundation Plantings and/or Removals;
- Wall Coverings;
- Water Heaters/Softeners;
- Windows/Screens;
- Window Treatments (Blinds, Drapes, and Other Treatments);

Ineligible Expenses

The following items are not eligible for RR reimbursement:

- Operating expenses;
- Items reimbursed by a previous draw;
- Items eligible to be replaced from alternative funding sources, such as:
 - Damages, paid for by the resident or legally deductible from a resident’s security deposit that has available funds to pay for the replacement,
 - Insurance reimbursements,
 - Trade-in allowances, and
 - Warranties.
- Minor repairs, such as locksmith fees, plumbing repairs, and other items maintenance items.

The following items are also **not** eligible for replacement:

- Computers and/or software;

- Deferred maintenance items – Items requiring replacement due to deferred maintenance. For example, deferred replacement of a roof that allows water to damage further items in the development's structure. The roof would be covered, but not the additional items;
- Lawn maintenance equipment;
- Maintenance supply items for routine items, such as batteries, light bulbs, and cleaning supplies;
- Minor HVAC system and boiler components, such as blower motors, circuit boards, heat exchangers, pilot lights, thermal couplings, thermostats, and other general maintenance components;
- New additions to a site;
- Office equipment and furniture ;
- Trucks or other vehicles;
- Uninstalled replacement items – Items kept in stock for anticipated replacements;
- Annual landscaping items, such as mulch, flowers, etc.

Requests for RR Disbursement

For the first 5 years after the 1st of the month following the mortgage closing, the RR may only be used for emergency replacement needs.

The Owner\Management Agent must submit an original written request for RR disbursement to the assigned Asset Manager in order to receive RR reimbursement. Electronic requests will **not** be accepted unless extenuating circumstances exist, such as an emergency replacement for the health and safety of the residents. The net amount of the request must exceed \$500 and include the following:

- Owner's RR Request form;
- Replacement Reserve (RR) Worksheet;
- Summary of invoices including the vendor, item description, quantity, invoice date, invoice number, unit number, and invoice amount;
- Invoices for all expenses requiring reimbursement must be:
 - Dated within 12 months of the draw request date to be eligible for reimbursement;
 - Included on the invoice summary;
 - Listed on the summary with the invoice amount being billed;
 - Invoices, not previously submitted for reimbursement; and,
 - Identify specific items to be reimbursed, if multiple items are on the invoice. For example, an invoice including garbage disposals, light bulbs, cleaners, and faucets must have the garbage disposals and faucets identified to clarify the items for which funds are being requested.
- MSHDA Exception Response Letter – if an exception has been approved.
- MSHDA Pre-approval Response Letter – if the cost of a single item (or project) replacement expenditure exceeds \$2,500, pre-approval of the expenditure is required as described in the "Requests for Pre-approval" section of this policy;

- Sworn Statements and Lien Waivers – if the cost of project expenditures exceeds \$100,000, sworn statements and lien waivers are required to be signed by the contractors and submitted with the draw.
 - If multiple draws for reimbursement occur during the course of the project, the development should request a sworn statement and conditional lien waiver with each payment to the contractor as the MSHDA Asset Manager may need these to approve the draw. The final sworn statement and lien waiver are required to be submitted with the final draw.

Replacement Reserve (RR) Worksheet – Completing this form helps the Managing Agent determine if MSHDA will allow the release of funds for RR draw requests or if operating funds available at the development must be used to fund RR items being requested. The worksheet compares the cash on-site against the development's total available cash. If the calculation determines that a development has enough on-site funds to pay for the requested items, the development will not be eligible for an RR draw. Developments may skip this required calculation if one of the following exceptions exists:

- The RR is adequately funded and the owner(s) has been making all recommended contributions;
- The RR is funded above \$5,000 per unit.

Requests for RR Draw Exceptions

In extenuating circumstances, exceptions to the policy may be granted. The Owner\ Management Agent may submit an electronic or original written request for exception to the development's assigned Asset Manager and must include sufficient documentation to justify the exception.

Requests for Pre-approval

Regardless of the funding source (RR account, Operating Reserve Cash, or other development reserves or operating cash), the Owner/Management Agent must request pre-approval of substantial replacements of building components, capital improvements, and other major repairs for single items (or projects) that exceed \$2,500. The Owner/Management Agent may submit an electronic or original written request for pre-approval to the development's assigned Asset Manager and include the following:

- A comprehensive description of the items to be replaced and all the work required to complete the replacement,
- A summary of the bids comparing each bid against the others to help validate the requested bid's benefits over the competing bids and identification of the bid being selected,
- At least three (3) independent comparable bids from qualified contractors for the completion of the work described in the scope of work

Bid Information – Bid for work must include the following:

- Name, address, and telephone number of the bidder;
 - Name and address of the development where the work is to be completed;
 - Building number, unit number, and/or specific location where work is to be completed;
 - Description of the work to be completed;
 - Specifications and total costs of materials and labor that the bidder proposes to use;
 - Certification that the materials to be used as described above meet or exceed the FHA minimum property standards and/or MSHDA Design Standards;
 - Name of the bidder's insurance agency, if applicable;
 - Down payment terms, if applicable;
 - Signature of bidder
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Forms and Attachments

Replacement Reserve Worksheet