STATE OF FLORIDA
FLORIDA HOUSING FINANCE CORPORATION

CASE NO. 2016-010VW

SOUTHERN VILLAS, LLC,
Petitioner

vs.

FHFC APPLICATION: 2014-377C
REQUEST FOR APPLICATIONS: 2014-104

FLORIDA HOUSING FINANCE CORPORATION,
Respondent

PETITION FOR WAIVER OF RULE 67-48.0072(13)(b)
FOR MAINTENANCE OF EXCESS RESERVE FUNDS

Petitioner Southern Villas, LLC, a Wisconsin limited liability company ("Southern Villas") submits its Petition to Respondent Florida Housing Finance Corporation (the "Corporation") for a waiver of the Corporation's prohibition on the escrow of replacement reserves in an amount exceeding 50% of the total amount of reserves required for a two year period. *See* Rule 67-48.072(13)(b), Florida Administrative Code.

In support of its Petition, Southern Villas states:

A. THE PETITIONER

1. The name, address, telephone and facsimile numbers, and email address for Southern Villas and its qualified representative for Southern Villas' application (the "Application") in response to RFA 2014-104 for the Preservation of Existing Affordable Housing Developments (the "RFA") are:

#4782008 v3
38575-0011

Southern Villas, LLC
200 North Main Street
Oregon, WI 53575
Attention: Hana Eskra
Telephone: (305) 668-5810
Facsimile: (608) 835-3922
E-Mail: heskra@gormanusa.com

2. The name, address, telephone and facsimile numbers for Southern Villas' attorney are:

Brian J. McDonough, Esq.
Stearns, Weaver, Miller, Weissler, Alhadeff & Sitterson, P.A.
150 West Flagler Street, Suite 2200
Miami, Florida 33130
Telephone: (305) 789-3350
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E-Mail: bmcdonough@stearnsweaver.com

B. THE DEVELOPMENT

3. Southern Villas timely submitted its Application in response to the RFA for the development named "Southern Villas" (the "Development"). *See* Application No. 2014-377C. Financing for the acquisition of the Development included the assumption, by Southern Villas, of the existing so-called "§515 loans" (the "Existing Debt") made by the United States of America acting through the Rural Housing Service, United States Department of Agriculture ("USDA") to the then-current owner. A component of the Existing Debt was an existing replacement reserve account previously funded in the amount of $486,515 (the Reserve Amount"), which could not be expended, depleted or reduced in any manner prior to the land closing under USDA regulations, and therefore had to be assumed by Southern Villas along with the principal balance of the Existing Debt. The Reserve Amount exceeds the allowable escrow of replacement reserves under Rule 67-48.072 (13)(b), Florida Administrative Code (the "Rule"), which for the Development, is $24,540. Accordingly, Southern Villas hereby petitions the

Corporation for a waiver of its prohibition on the escrow of replacement reserves in an amount exceeding 50% of the total amount of reserves required for a two year period.

4. The requested rule waiver will not adversely affect the Development. However, a denial of this Petition (a) will result in a substantial economic hardship to Southern Villas and (b) could deprive the residents of St. Johns County, Florida of 60 units of affordable housing and (c) would violate principles of fairness[1]. Section 120.542(2), Fla. Stat. (2015).

5. The waiver being sought is permanent in nature.

C. RULES FROM WHICH WAIVER IS SOUGHT

6. Southern Villas requests a waiver from Rule 67-48.0072(13)(b) of the Florida Administrative Code (the "Rule"). Specifically, Southern Villas is requesting approval of the escrow of replacement reserves in an amount which exceeds 50% of the total amount of reserves required for a two year period. The Rule provides, in relevant part, as follows:

> **(13) For Competitive HC, SAIL, and HOME, in addition to operating expenses, the Credit Underwriter must include an estimate for replacement reserves and operating expense reserves deemed appropriate by the Credit Underwriter when calculating the final net operating income available to service the debt. A minimum amount of $300 per unit per annum must be used for all Developments.**
>
> **.......**
>
> **(b)... An Applicant may choose to fund a portion of the replacement reserves at closing. The amount cannot exceed 50 percent of the required replacement reserves for two (2) years and must be placed in escrow at closing.**

D. STATUTES IMPLEMENTED BY THE RULE

7. The Rule is implementing, among other sections of the Florida Housing Finance Corporation Act, the statute that designated the Corporation as the housing credit agency

[1]" Principles of Fairness" are violated when literal application of a rule affects a particular person in a manner significantly different from the way it affects other similarly situated persons who are subject to the rule. Section 120.542(2), Florida Statutes.

responsible for the allocation and administration of Low-Income Housing Tax Credits. See Section 420.5099, Florida Statutes.

E. PETITIONER REQUESTS A WAIVER FROM THE RULE FOR THE FOLLOWING REASONS

8. Southern Villas requests a waiver from Rule 67-48.0072(13)(b), Florida Administrative Code. Southern Villas is seeking a waiver from the Rule prohibiting the escrow of replacement reserves in an amount exceeding 50% of the total amount of reserves required for a two year period. Under Section 120.542(1), Fla. Stat., and Chapter 28-104, F.A.C., the Corporation has the authority to grant waivers to its rule requirements when strict application of these rules would lead to unreasonable, unfair and unintended consequences in particular instances. Waivers shall be granted when (1) the person who is subject to the rule demonstrates that the application of the rule would create a substantial hardship or violate principles of fairness, and (2) the purpose of the underlying statute has been or will be achieved by other means by the person. § 120.542(2), Fla. Stat. (2011).

9. The following facts demonstrate the circumstances which justify Southern Villas' request for waiver:

    a. Southern Villas timely submitted its Application to the Corporation in response to the RFA, for the rehabilitation and preservation of 60 affordable housing units intended for occupancy by elderly households. Southern Villas was invited into credit underwriting for an allocation of housing credits on July 29, 2014. It closed on its acquisition and construction loans for the Development and the syndication of the housing credits on November 20, 2015.

    b. The acquisition of the Development was funded, in part, by Southern Villas' assumption of the Existing Debt, including the Reserve Amount.

c. The maintenance of the Reserve Amount is governed by the provisions of 7 CFR §3560.306 (the "Code"). Under the Code and its attendant Asset Management Handbook (the "Handbook") published by the Rural Housing Service within the USDA, the Reserve Amount can be used only for planned expenditures for replacements that are presented in the annual budget submitted to USDA prior to the beginning of the Development's fiscal year. Special circumstances allow for disbursements in the event of emergency capital repair needs. Copies of the relevant Code and Handbook sections are attached hereto as Exhibits "A" and "B", respectively.

d. The Development's current annual budget submitted to USDA includes a line item for disbursement of $100,000 from the Reserve Amount for (a) asphalt repairs or replacement and (b) sewer laterals, which will be accomplished during the renovations which are currently ongoing. This will deplete the Reserve Amount to $386,515, resulting in an excess of $361,975 over the amount allowed under the Rule.

e. The current fiscal year for the Development ends on September 30, 2016. There is no opportunity to amend the Development's current annual budget prior to submission of the budget for the next fiscal year, which commences on October 1, 2016, to withdraw any additional funds from the Reserve Amount in a effort to bring it closer to the amount allowed under the Rule. As evidenced by the letter from USDA attached hereto as Exhibit "C" (the "USDA Letter") it is not permissible to draw down or deplete the Reserve Amount unless the withdrawal is approved by USDA.

f. The Code allows for the use of funds from the Reserve Amount for emergency purposes. At this time there is no emergent situation at the Development that would warrant an immediate disbursement that would bring the Reserve Amount closer to (or under) the limitations established under the Rule.

g. USDA requirements pertaining to its §515 loans such as those assumed by Southern Villas strictly limit the net cash flow that can be realized by the owners of such projects. Any return to the owner is required to be put into reserve accounts controlled by USDA such as the one in which the Reserve Amount is held, so there is no avenue for diversion or expenditure of the excess. The Reserve Amount is not available to Southern Villas to be spent in its discretion. Simply stated, Southern Villas has no alternative other than to continue to maintain, and even increase, the Reserve Amount in the manner required by the USDA under the Code.

h. For further information on the restricted nature of the Reserve Amount as controlled by USDA, please see the USDA Letter.

i. The Reserve Amount was not funded by Southern Villas at closing of the acquisition of the Development through any allocation of the loan proceeds or equity secured by Southern Villas for the Development. It was a previously-funded account which was assumed as part of the acquisition of the Development and such assumption was a non-negotiable feature of the transaction.

j. Southern Villas' scoring and allocation of housing credits would not have been affected by the existence of the excess Reserve Amount. There are no points associated with this aspect of the Application. Nor does this change adversely impact any other applicant in the RFA.

10. A waiver of the Rule's prohibition on the escrow of replacement reserves in an amount exceeding 50% of the total amount of reserves required for a two year period restriction would serve the purposes of Section 420.5099, F.S., and the Act as a whole, because one of

the Act's primary purposes is to facilitate the availability of decent, safe and sanitary housing in the State of Florida to households of limited means.

11. If the waiver requested herein is not granted, Southern Villas will suffer a substantial economic hardship by failing to meet the technical requirements of the Rule upon completion of the development. Failure to obtain IRS Form 8609 from the Corporation will result in recision of the allocation of housing credits awarded to the Development. Southern Villas' investor member will withhold the equity contribution earmarked for paydown of its bridge financing upon benchmarks which include (a) the issuance of the Certificate of Occupancy, (b) the stabilization of the Development and (c) the issuance of the Form 8609, if the housing credits cannot be delivered as contemplated. Further hardship will stem from recapture obligations that will be owed to the investor member for capital contributions made prior to the benchnmarks enumerated above. The Development will fail altogether as an affordable housing community.

12. Should the Corporation require additional information, a representative of Southern Villas is available to answer questions and to provide all information necessary for consideration of this Petition.

F. ACTION REQUESTED. Southern Villas requests the following:

a. That the Corporation grant Southern Villas a waiver from Rule 67-48.0072(13)(b), Florida Administrative Code, allowing it to escrow replacement reserves in an amount exceeding 50% of the total amount of reserves required for a two year period;

b. That the Corporation grant the Petition and all the relief requested therein; and

c. That the Corporation grant such further relief as may be deemed appropriate.

Respectfully submitted,

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By: ______________________
BRIAN J. MCDONOUGH, ESQ.

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CERTIFICATE OF SERVICE

The Petition is being served by overnight delivery for filing with the Corporation Clerk for the Florida Housing Finance Corporation, 227 North Bronough Street, Suite 5000, Tallahassee, Florida 32301, with copies served overnight delivery on the Joint Administrative Procedures Committee, Pepper Building, Room 680, 111 West Madison Street, Tallahassee, Florida 32399-1400, this 17th day of January, 2016.

Brian J. McDonough, Esq.

#4782008 v3
38575-0011

§3560.304 Initial operating capital.

(a) *Purpose.* To provide a source of capital for start-up costs, such as the purchase of equipment, and paying operating, maintenance, and debt service expenses. Borrowers are required to make an initial operating capital contribution to the general operating account as described in §3560.64.

(b) *Authorized uses of initial operating capital.* Initial operating capital may be used only to pay for approved budgeted expenses.

(c) *Withdrawal of initial operating capital.* Initial operating capital funds may be withdrawn by a borrower if:

(1) The initial operating capital was provided from the borrower's own funds;

(2) The borrower requests the withdrawal after the second year of housing project operations and prior to the 7th year of operations;

(3) The housing project has had a 90 percent occupancy rate for a period of 12 months prior to the withdrawal request;

(4) The withdrawal will not affect the financial viability of the housing project;

(5) Contributions to the reserve account are at authorized levels;

(6) The withdrawal request will not result in rent increases; and

(7) There are no outstanding deficiencies in management's physical maintenance of the housing project.

⇡ Back to Top

§3560.305 Return on investment.

(a) *Borrower's return on investment.* Borrowers may receive a return on their investment (ROI) in accordance with the terms of their loan agreement and the following:

(1) If there is a positive net cash flow in housing project operations, the ROI may be taken by the borrower after the housing project's fiscal year, provided that the balance of the reserve account is equal to or greater than required deposits minus authorized withdrawals. If the annual financial reports indicate that an ROI should not have been taken, borrowers will be required to return any unauthorized ROI.

(2) If there is negative cash flow in housing project operations, the Agency may authorize the borrower to take the ROI only after the Agency has reviewed the housing project's annual financial reports and determines:

(i) Surplus cash exists in either the general operating account as defined in §3560.306(d)(1) or the reserve account, if the balance is greater than the required deposits minus authorized withdrawals.

(ii) The housing project has sufficient funds to address identified capital or operational needs.

(b) *Unpaid return on investment.* An earned, but unpaid ROI for the previous year only may be requested by the borrower and authorized by the Agency under the provisions of §3560.305(a)(2) provided the current year's ROI has been paid first and a rent increase is not required to generate funds to pay the unpaid ROI.

⇡ Back to Top

§3560.306 Reserve account.

(a) *Purpose.* To meet the major capital expense needs of a housing project, borrowers must establish and maintain a reserve account.

(b) *Financial management of the reserve account.* Borrower management of the reserve account is subject to the requirements of 7 CFR part 1902, subpart A regarding supervised bank accounts.

(c) *Funding of the reserve account.* Borrowers must make payments to the reserve account in the amount established in loan documents, beginning with the first loan payment or a date specified in loan documents.

(d) *Transfer of surplus general operating account funds.* (1) The general operating account will be deemed to contain surplus funds when the balance at the end of the housing project's fiscal year, after all payables, exceeds 20 percent of the operating and maintenance expenses. If the borrower is escrowing taxes and insurance premiums, include the amount that should be escrowed by year end and subtract such tax and insurance premiums from operating and maintenance expenses used to calculate 20 percent of the operating and maintenance expenses.

Exhibit A

(2) If a housing project's general operating account has surplus funds at the end of the housing project's fiscal year, the Agency will require the borrower to use the surplus funds to address capital needs, make a deposit in the housing project's reserve account, reduce the debt service on the borrower's loan, or reduce rents in the following year. At the end of the borrower's fiscal year, if the borrower is required to transfer surplus funds from the general operating account to the reserve account, the transfer does not change the future required contributions to the reserve account.

(e) *Account requirements.* Borrowers must establish and maintain the reserve account according to §3560.65, §3560.302(c)(5), and the following requirements:

(1) Reserve accounts must be deposited in interest-bearing accounts or securities; and

(2) Reserve accounts must be supervised accounts that require the Agency to countersign on all withdrawals; except, this requirement is not applicable when loan funds guaranteed by the Section 538 GRRH program are used for the construction and/or rehabilitation of a direct MFH loan project. Direct MFH loan borrowers, who are exempted from the supervised account and countersigned requirement, as described above, must follow Section 538 GRRH program regulatory requirements pertaining to reserve accounts. In all cases, Section 538 lenders must get prior written approval from the Agency before reserve account funds involving a direct MFH loan project can be disbursed to the borrower.

(f) *Funds invested in securities.* In addition to the requirements specified in paragraph (e) of this section, the following requirements apply when reserve funds are invested in securities:

(1) The reserve account must be held either at a Federally insured domestic institution such as a bank, savings and loan association, credit union, or at a domestic institution authorized to sell securities.

(2) The borrower must record the price actually paid for the securities. When designated as a reserve deposit, the price paid must equal the required contribution to reserves.

(3) Borrowers must be knowledgeable about industry practices and consider the impact of typical fees and charges for purchases and sales and maintenance of an account when making investment decisions. Such fees may be paid for out of reserves, only with the consent of the Agency. Housing project funds may not be used to pay for a financial advisor.

(g) *Use of the reserve account.* (1) Borrowers must request Agency approval of reserve account withdrawals prior to the withdrawal. Borrowers must inform the Agency of planned uses of reserve accounts in their annual capital budget if known at budget planning time. Any item on the approved capital budget does not require additional pre-approval by the Agency.

(2) The Agency will indicate any conditions governing withdrawals from a reserve account at the time it approves the withdrawal.

(3) In emergency situations, the Agency may specify special procedures to provide an expedited approval process for the use of the reserve account.

(4) The Agency may approve the use of reserve funds for operating costs when circumstances that are determined by the Agency to be beyond the borrower's control have resulted in a shortfall in the housing project's general operating account.

(5) Funds from the replacement reserve account cannot be used to pay any fees associated with the Section 538 GRRH loan guarantee, as determined by the Agency.

(h) *Allowable uses.* Allowable uses of reserve funds include the following:

(1) Major capital improvements and replacements.

(2) Housing project operating expenses provided the requirement of paragraph (g)(4) of this section has been met, including:

(i) Payments due on the loan, or

(ii) Payment of a return on investment at the end of the borrower's fiscal year if such payment comes from surplus operating funds in the reserve account.

(3) With Agency approval, borrowers operating on a for-profit or a limited profit basis may make an annual withdrawal from the reserve account, equal to no more than 25 percent of the interest earned on a reserve account during the prior year.

(4) For other purposes, which in the judgment of the Agency will promote the loan purposes, strengthen the security or facilitate, improve, or maintain the housing and the orderly collection of the loan without jeopardizing the loan or impairing the adequacy of the security.

(i) *Records.* Borrowers must maintain records documenting all expenses that were paid by withdrawals from the reserve account.

(j) *Changes to reserve requirements.* (1) As projects age, the required reserve account level may be adjusted to meet anticipated "life-cycle" needs, including equipment and facility replacement costs, by amending the loan agreement/resolution.

(2) The Agency may approve a change in the reserve account funding level based on the findings of an approved capital needs assessment. The approval to increase reserve account funding levels will take into consideration the housing project's approved budget and the housing project's ability to support increased reserve account deposits without causing basic rents to exceed conventional rents for comparable units in the area.

(k) *Excess reserves.* Amounts in the reserve account which exceed the total required by the loan or grant agreement must be used, at the direction of the Agency, for any of the following:

(1) Pay for expenses specified in a long-term capital plan;

(2) Make payments and reamortize the Agency loan;

(3) Reduce rents by a transfer to the general operating account;

(4) Fund preservation incentives authorized in subpart N of this part; or

(5) Cover other expenditures determined to be related to the purpose of the housing project and in the best interest of the Federal Government.

(l) *Procurement.* The requirements of §3560.102(g), (j), and (k), and all other Agency requirements relating to procurement, bidding, identity-of-interest, cost-reasonableness, and construction management apply to any work or services paid out of reserve funds. Structural repairs and other significant work on major building systems such as heating or air conditioning must be done in accordance with the requirements of 7 CFR part 1924, subpart A.

[69 FR 69106, Nov. 26, 2004, as amended at 80 FR 34532, June 17, 2015]

↑ Back to Top

§3560.307 Reports.

(a) *Required reports.* Borrowers must submit required reports using Agency-approved formats.

(b) *Quarterly and monthly reports.* The Agency may require quarterly or monthly reports to monitor financial progress when closer supervision is warranted.

↑ Back to Top

§3560.308 Annual financial reports.

(a) *General.* Borrowers must submit annual financial reports that meet the requirements of this section. The annual financial reports to be submitted are the Multi-Family Housing (MFH) Project Budget with actual expenditures and the MFH Balance Sheet. Annual financial reports are due to the Agency within 90 days of the end of the borrower's fiscal year.

(1) Borrowers with 16 or more units in their housing project must base their annual financial reports on an engagement report completed according to agreed upon procedures established by the Agency as specified in paragraph (b) of this section. Borrowers must include the engagement report with their annual financial reports submitted to the Agency.

(2) Borrowers with less than 16 units in their housing project must submit annual financial reports using a limited scope engagement based on Agency approved procedures and certify that the housing meets the performance standards established in paragraph (c) of this section. Borrowers may use a CPA to prepare this report. For properties that prepare a limited scope engagement, the Agency may undertake random audits, once every two or three years.

(3) If a third party requires it, the borrower may have a CPA prepare an audit in accordance with generally accepted government auditing standards (GAGAS). Costs incurred to obtain this audit are an allowable project expense.

(b) *Engagement requirements.* Borrowers required to submit annual financial reports based on an engagement performed by a CPA must meet the following requirements:

(1) Borrowers must use an Agency approved engagement letter. Borrowers must submit the results of an engagement that examines specific records using agreed upon procedures established by the Agency and that describes the borrower's performance in meeting the standards described in paragraph (c) of this section.

SECTION 3: REPLACEMENT RESERVES *[7 CFR 3560.306]*

4.12 PURPOSE OF RESERVES

The Agency has a financial interest in a project over the life of its loan. During this period, which can be as long as 50 years, major replacements and capital expenditures will have to be made to the building, such as replacing the roof, rewiring, replacing windows, doing major exterior work, and adding new kitchen and bathroom fixtures. The reserve account is primarily used to meet the major capital expense needs of a project. If these expenditures are not made, the property loses value, becomes less attractive to tenants, and begins to deteriorate, and the Agency's financial interest is at risk.

In most cases, such expenditures cannot be met out of annual operating income. Therefore, the Agency requires that a certain amount of rental income each month be deposited in a special, interest-bearing savings account—a reserve account—with rates greater than or equal to passbook savings or checking accounts. The Agency's expectation is that over time, the accumulation of funds in this account will be sufficient to meet these major capital costs. Adequate replacement reserves are a critical component of a successful project.

4.13 RESERVE ACCOUNT REQUIREMENTS

The reserve account is a required account subject to the requirements set out in this paragraph. The borrower will initiate monthly deposits in this project account, starting the same month the first loan payment is due the Agency. As projects age, the required reserve account level may be adjusted to meet anticipated life-cycle needs, including equipment and facility replacement costs, by amending the loan agreement/resolution.

- All Rural Rental Housing, Rural Cooperative Housing, and Farm Labor Housing borrowers are required to establish and maintain a reserve account. This requirement excludes On-Farm Labor Housing borrowers with less than12 units.
- Effective July 26, 1994, reserve funds were required to be placed in a supervised account. The provisions of 7 CFR part 1902, subpart A, apply. Reserve funds on deposit prior to this date in instruments that are subject to monetary penalties for early withdrawal may be temporarily held for the time needed to avoid such penalties.

4.14 RESERVE INSTALLMENTS

Immediately after paying each installment for the orderly retirement of the Agency loan as provided in the borrower's *Form RD 3560-52, Promissory Note* required reserve installments will be transferred to the Reserve Account at least at the required rate stipulated by the borrower's loan agreement or resolution starting with the date the first payment is due to the Agency. Transfers will continue until the account reaches the total amount specified in the loan agreement or resolution. Transfers will be resumed the period following withdrawals that decrease the reserve account balance below its required level until it is restored to the specified

EXHIBIT B

total minimum sum.

As projects age, the required reserve account level may be adjusted to meet anticipated "life-cycle" needs, including equipment and facility replacement costs, by amending the loan agreement/resolution.

The Agency may approve a change in the reserve account funding level based on the findings of an approved capital needs assessment. The approval to increase reserve account funding levels will take into consideration the housing project's approved budget and the housing project's ability to support increased reserve account deposits without causing basic rents to exceed conventional rents for comparable units in the area.

The Agency may approve a borrower's request to increase the required level of the reserve account to ensure sufficient funds are available to address capital requirements of a transition plan. Loan funds may also be used for this purpose.

4.15 RESERVE ACCOUNT PRINCIPLES

Reserve account funds are governed by the following principles:

A. Investment Vehicles and Institutions

Reserve account funds not immediately needed to pay for expenses or authorized purposes may be held as set out in this paragraph. Reserve account funds may be held in the form of a checking, savings, negotiable order of withdrawal, or similar account at a federally insured domestic institution, such as a bank, savings and loan, or credit union.

- Reserve account funds may be held in the form of readily marketable obligations of the U.S. Treasury Department (e.g., U.S. Treasury bonds, U.S. Savings bonds, zero coupon bonds, etc.) at a federally insured domestic institution or at an insured domestic institution authorized to sell securities.

- Reserve account funds may also be held in the form of an account (the account may be a tax exempt account or a taxable account) established at an insured domestic institution authorized to sell securities (the institution may or may not charge brokerage fees), provided the accounts meet the remaining conditions set out in this paragraph and are not used in a speculative manner.

B. Limitations on Investments in Securities

Any securities must be backed by the U.S. Government or an Agency of the U.S. Government, or be triple A-rated Government National Mortgage Association collateralized tax-exempt bonds or be triple A-rated pre-refunded bonds. Pre-refunded bonds are bonds that originally may have been issued as general obligation or revenue bonds but are now secured, until the call date or maturity, by an escrow fund consisting entirely of direct Government obligations that are sufficient for paying the bondholders.

C. Reporting Actual Costs of Securities

To assure that required amounts have been paid into the reserve account, the actual costs of securities (which in many cases may not be the face value) must be shown on the project books. In addition, details of these transactions should be disclosed in footnotes to financial information provided to the Agency.

1. Security Sales

When the Agency approves withdrawals from the reserve account and the funds are invested in securities, borrowers must, to the extent that securities are available, assure that securities are sold in an amount that results in proceeds sufficient to cover the disbursement.

2. Forecasting Security Sales

Since the sale or redemption of any securities may result in cash proceeds of less than the amount invested, borrowers should take steps to minimize the risk of loss from converting securities to cash. Needed reserve account withdrawals should be forecasted well in advance to permit Agency approval of anticipated needs, such that security sales can be arranged to be sold in favorable market conditions. When sales of securities take place, the proceeds will normally be held in a reserve fund at a domestic bank, savings and loan, credit union, or similar institution insured by an Agency of the Federal Government until such time as withdrawals are actually needed for the purposes authorized. Should unusual circumstances require the sale of securities in unfavorable market conditions, the borrower will not be required to reimburse the project for any losses incurred.

3. Knowledge Required of Securities Investors

Those investing in securities must be knowledgeable of common industry practices prior to investing in securities. Knowledge of the various fees that may be associated with the purchase and sale of securities and the maintenance of security accounts must be considered when making security investments (e.g., front-end loads or fees, back-end loads or fees, maintenance fees, etc.). Such fees may be paid by the general operating account or by the reserve account. However, the Agency must give its prior consent before reserve account funds may be used.

4. Financial Advisor Limitations

Project proceeds may not be permitted to be used to pay for the services of a financial advisor to assist in the selecting of securities for investments, since the securities permitted are relatively limited and must meet the requirements set out herein. However, normal brokerage fees may be paid to secure and sell securities. It is recognized that financial advice may also be provided as part of the normal brokerage fee.

4.16 ELIGIBLE USES OF THE RESERVE ACCOUNT

A. Planned Use of Reserves

The borrower will request withdrawal from the reserve funds using *RD Form 3560-12, Request for Authorization to Withdraw Reserve Funds,* before they are needed. Annual budgets are to include realistic routine income and expense levels to avoid the need to use the reserve for routine expenses (operating shortfalls), not caused by emergencies or very unusual servicing situations. The Agency expects borrowers to anticipate and plan for major capital expenditures at least annually.

The borrower is required to submit an annual capital expenditure budget as part of the annual budget submission. The Loan Servicer reviews these documents, as well as the annual report of actual expenditures to ensure that the borrower includes expenditures adequate to maintain the property to Agency standards. This should include plans to catch up with any maintenance expenses deferred from previous years, or to correct any deficiencies identified during Agency site visits. Marshal and Swift "Residential Cost Handbook" provides data on projected useful life of materials with graphic representations of common replacement and repair schedules for reference.

The borrower must submit a written request to the Agency to use reserve funds, even if the Agency has reviewed and approved the capital expenditures in its review of the annual capital budget.

B. Unanticipated Uses of Reserves

The Agency recognizes that not all capital expenditures can be predicted a year in advance. Sometimes a major piece of equipment will break down unexpectedly or a severe storm will create damage. Borrowers must seek Agency approval for the unforeseen use of reserves. In emergency situations when the borrower can demonstrate an imminent and serious threat to the health, safety, or physical security of the project, the borrower may request the Agency to post-approve the use of reserves. The Agency will only approve emergency withdrawals if the reserves are used for eligible expenses.

C. Authorized Uses/Eligible Expenditures

The Loan Servicer will take prompt action on a request for reserve withdrawal (normally within <u>5 working days</u> of the request) and provide written authorization to the borrower for any authorized withdrawal of funds by the use of *Form RD 3560-12* before the borrower actually withdraws any funds. Authorized purposes include:

- To make improvements to the housing project without creating new living units or to retrofit units to make them accessible to the physically handicapped.
- The use of reserve funds to address the capital requirements identified by the borrower's transition plan may be considered an authorized use of reserve account funds. Loan funds may also be used for this purpose.

- Make permanent improvements to the housing project, such as installing an energy-conserving heat pump or making a unit accessible to persons with disabilities.

- For other purposes desired by the borrower, which in the judgment of the Government will promote the loan purposes; strengthen the security; or facilitate, improve, or maintain the project and the orderly collection of the loan without jeopardizing the loan or impairing the adequacy of the security. Reserve funds may also be used to facilitate payment of fees associated with the buying or selling of securities or maintaining a securities account.

- To meet payments due on the loan obligations in the event the amount for debt service is not sufficient for that purpose.

- Meet an emergency shortfall in operating expenses when the emergency is beyond the control of the borrower and threatens life, safety, or the physical security of the project. Examples might include an extreme weather disaster or reductions in rental income caused by changes in the rental market that affect other housing projects as well. In cases of weather disasters, the project insurance coverage will be reviewed to determine if funding from insurance will be available for repairs.

- With Agency approval, borrowers operating on a for-profit or a limited profit basis may make an annual withdrawal from the reserve account, equal to no more than 25 percent of the interest earned on a reserve account during the prior year. The borrower uses *Form RD 3560-12*, requesting the withdrawal and must provide documentation of the prior year interest earned.

- To pay a ROI at the end of the borrower's project operating year, provided that after these disbursements the amount in the reserve account will not be less than that required by the loan agreement or resolution to be accumulated by that time (taking into consideration the provisions of any approved servicing plan which may be authorizing a temporary adjustment to these provisions), minus any authorized withdrawals, and provided that the amount in the reserve account will likely not fall below that required to be accumulated during the next 12 months.

  ◊ In the case of borrowers' operating on a limited-profit basis, paying a return on the borrower's initial investment as identified in the loan agreement or resolution; and

  ◊ In the case of borrowers' operating on a full-profit basis, paying an annual return as specified in the borrowers' loan agreement or resolution.

4.17 THE WITHDRAWAL PROCESS

A. Common Procedure

The procedures that the borrower and the Agency use vary with the complexity and cost of the project for which reserve funds are sought. However, some steps are used in all cases:

- The borrower writes to the Field Office using *Form RD 3560-12* to request the use of reserve funds for a capital expenditure. The request will include:
  - ◊ A statement of the purpose and a description of the project for which reserves will be used;
  - ◊ The current balance in the account and other activity, such as deposits and withdrawals;
  - ◊ The estimated cost of the project;
  - ◊ Copies of bids, if appropriate;
  - ◊ A copy of the approved capital budget that included the project or an explanation of why the project was not included in the annual capital budget; and
  - ◊ A statement of the current balance in the reserve account.
- The Servicing Office reviews the request:
  - ◊ If the request is for a project that was included in the annual capital budget and approved during the Agency review of the engagement report, and is not a substantial construction activity, the Servicing Office must complete its review within <u>5 business days</u>.
  - ◊ If the request is for a capital expenditure that is not an emergency and was not part of the annual capital budget, the Servicing Office has <u>10 business days</u> to complete its review.
- The Servicing Office notifies the borrower in writing of the decision to:
  - ◊ Approve the request;
  - ◊ Approve the request with conditions; or
  - ◊ Reject the request (this must include the reasons for rejection and an explanation of the borrower's appeal rights).

- The borrower submits a request for payment, supported by an invoice and accompanied by a two-party check made out to the vendor or contractor.

B. Bid Requirements

The expenditure of reserve funds for a project (all work included in one contract) estimated to cost more that $3500 will require a minimum of two bids. Where there is an identity of interest (IOI) between the borrower or property manager and a bidder, the entity with the IOI must submit its bid directly to the Servicing Office, prior to requesting bids from other firms. The Agency requires at least two bids from other firms or an explanation of why the borrower was unable to obtain two bids.

C. Projects Involving Moderate Levels of Construction

These are projects that do not involve any substantial changes to the structure or replacement of major systems (electrical, plumbing, heating, or cooling) and cost less than $100,000. Examples could include exterior repainting, roof repair, parking lot repaving, and repairs to plumbing or electrical systems. When the borrower requests access to reserves for a moderate construction activity, the Agency first reviews the project documents and then reviews a payment request.

In addition to the items specified above, the borrower must provide:

- Project planning documents that describe the work to be performed;
- Copies of written bids; and
- A copy of the contract/proposal.

After the project has been completed, the borrower submits a request for payment, supported by an invoice and accompanied by a two-party check made out to the vendor or contractor.

D. Larger Construction Items

These activities involve substantial changes to the structure, replacement of major systems, or expenditures in excess of $100,000. Such activities are subject to the design requirements of RD Instruction 1924-A and RD Instruction 1924-C. In addition to the items specified above, the borrower must provide:

- Project planning documents, including specifications and drawings as necessary to fully describe the work;
- Copies of written bids;
- A rationale for awarding the contract; and
- A copy of the construction contract.

The required planning documents may be prepared by any individual or firm meeting the qualifications requirements of the local building jurisdiction. After the planning documents and construction contract have been accepted by the Agency, the borrower may request an initial draw to pay for materials or make a down payment to the contractor. The request for an initial draw should be accompanied by an invoice and a check made out to the contractor or vendor, to be cosigned by the Agency. The Agency may approve such a request provided the amount of the initial draw does not exceed a reasonable percentage of the value of the construction contract.

The Agency will inspect the project before approving the work and again at construction completion before approving the final payment. The purpose of the initial inspection is to establish that the proposed work is needed and an appropriate response to existing conditions. The purpose of the final inspection is to establish that the work was performed as described in the Agency-accepted documents. The Agency may conduct additional inspections as necessary. The borrower should be required to hire an independent third-party inspector to verify that the work complies with all applicable requirements.

4.18 EXCESS RESERVES

Any amount in the reserve account that exceeds the total sum specified in the loan agreement or resolution may be transferred to the general operating account for the authorized purposes only when it is agreed between the borrower and the Agency to be in excess of the requirement and there is a specific need for the excess funds. However, the Loan Servicer may direct the excess sum to be retained in the reserve account or applied as an extra payment on the loan.

USDA

United States Department of Agriculture

Rural Development

Florida/Virgin Islands
Multi-Family
Housing Programs

4440 NW 25th Place
PO Box 147010
Gainesville, FL 32614

Voice 352.338.3497
Fax 352.338.3490

February 16, 2016

To Whom It May Concern:

Southern Villas, LLC. assumed the indebtedness of St. Johns Housing Partnership, Inc. including a new MPR 515 Loan issued by Rural Development. This loan was initially obligated to the former owner in 2009 and was underwritten off of a 2009 Capital Needs Assessment.

This loan closed November 20, 2015 under the same terms in which it was underwritten. Per Rural Development underwriting guidelines, we no longer stipulate a "fully funded amount" for reserve bank accounts. Reserves are now dependent upon the changing needs of the property per the CNA. The annual deposits vary dependent upon the needs of the property per the CNA.

The reserve account cannot be drawn down unless the withdrawals are in accordance with CNA. The reserve balance played a role in the underwriting of this loan and the CNA annual deposits were based off the initial balance and repairs needed to the property.

Once the rehabilitation is complete an updated CNA can be provided by the owner, Southern Villas, LLC., and the reserve deposits and withdrawal requirements can be adjusted.

The reserve account is vital to Rural Development properties as it ensures there is enough funding to maintain the property and future repairs. The operating budgets that are submitted each year effective January 1st are based off the CNA, reserve deposits, and withdrawals (which must be preapproved). If these accounts experience withdrawals that are not directly related to the CNA and budgeted for (or due to an emergency), it can potentially cause the property to have a delinquent reserve account which would put them in default.

Thank you for your consideration and please contact Katrina Moseley, MFH Specialist, at 352.338.3438 if you have any questions.

Sincerely,

KATRINA MOSELEY

Digitally signed by KATRINA MOSELEY
DN: c=US, o=U.S. Government, ou=Department of Agriculture, cn=KATRINA MOSELEY, 0.9.2342.19200300.100.1.1=12001002034380
Date: 2016.02.16 08:49:31 -05'00'

Attachments

KRMoseley/km

Exhibit C