B. Legal Documents

The following legal documents should be reviewed to assist both the owner and management agent in understanding their duties and responsibilities in operating any PHFA-financed property.

1. Regulatory Agreement

The Regulatory Agreement defines the terms, conditions, and covenants that the owner agrees to be monitored by PHFA. The property's independent auditor must read this document to determine if the property is in compliance with PHFA rules and regulations. Although the contents of this document may vary, the following items are generally identified and defined in the agreement:

<u>Agreement to be regulated:</u> "Agency is unwilling to lend the aforesaid sum unless and until Owner shall, by agreeing to the terms, conditions and covenants set forth below, consent to hereby be regulated and restricted by Agency."

<u>Excess Revenue:</u> Excess Revenue is defined as the excess of earnings from the operation of the property at the end of the annual fiscal period after payment of the property's operating costs required by the Agency. Generally, a listing of appropriate operating costs is included with this description.

<u>Management Agreement:</u> PHFA requires that a professional management agent be hired to properly operate the property. The Management Agreement is the contract between the property owner, the management agent, and PHFA. **Prior approval by PHFA is required for all management agents. Also, no change in management agent may take place without the prior written approval of PHFA.**

<u>Return on Equity:</u> Distributions to owners are limited to a specified percent of owner's equity, the amount of equity being determined by PHFA at the final loan closing based on the Agency approved cost certification. Distributions are made on an annual basis and only after written prior approval by PHFA. The right to such distribution shall be cumulative commencing from the date of cost certification.

<u>Rental Project Restrictions:</u> The number of units restricted to be leased to individuals or families of various area median incomes as defined in the Regulatory Agreement.

Reserve Fund for Replacements: Funding of this account on a monthly basis is required by the Regulatory Agreement. Withdrawals from this fund require approval from PHFA and may only be made for appropriate items. (see appendix #2)

Residual Revenue Fund: Residual Revenue as defined in the Regulatory Agreement must be submitted to PHFA when requested.

Owner Distribution: The owner may not make any distributions without the prior written approval of PHFA.

Audit: The Management Agent is required to maintain the books and records of the property in a proper manner to allow for an audit. Annual financial statements prepared by a certified public accountant are to be submitted to PHFA within ninety days following the end of the property's fiscal year for all properties of 12 or more units.

Annual Budget: PHFA requires that a budget be submitted to PHFA not less than sixty (60) days prior to initial occupancy and not less than sixty (60) days prior to the beginning of each fiscal year of the property. The budget must be submitted in the format prescribed by PHFA.

Transfers of Ownership: No transfer of ownership of the property may take place without the prior written consent of PHFA.

2. Management Agreement

The Management Agreement is a contract between the property's owner and the management agent which must be approved by PHFA. The following categories are generally found in the Management Agreement of a PennHOMES property consisting of twelve (12) or more units:

Agent's Compensation: From the date of initial occupancy, the management fee will be an amount determined by multiplying the approved management fee factor by the amount of **gross income** for the preceding calendar month. The management fee factor should not be less than 5% nor exceed 10% and cannot be changed without prior approval from PHFA.

Subject to the Regulatory Agreement: The agent agrees to comply with all requirements of the Regulatory Agreement which is executed between the owner and PHFA. Nothing contained in the Management Agreement shall in any way be construed as limiting or affecting the rights of PHFA under the Regulatory Agreement.

Security Deposits: PHFA requires that a security deposit account be maintained for the property as per the Landlord-Tenant Act of 1951. This account **must** be segregated from other bank accounts and should always be sufficiently funded to cover the offsetting liability account.

Maintenance and Repair: Prior written approval is required from PHFA for any single expenditure exceeding a PHFA designated dollar amount ($5,000 for 100 units or less and $10,000 for more than 100 units). Recurring operating expenses and emergency repairs are excluded from this requirement.

Records and Reports: The Management Agreement requires that a quarterly operating report be submitted to PHFA by the fifteenth (15th) of each month for the preceding quarter in the format prescribed by PHFA. Selected additional financial information that must be submitted with the quarterly operating report will also be listed in this section of the Agreement.

Monthly Rental Amounts: The initial contract rents, utility allowances (if any), and gross rents will be recorded in this section.

Tax and Insurance Escrow: PHFA requires that a tax and insurance escrow account be maintained by PHFA for the life of the property.

Collection of Rents and Other Receipts: The Agent will collect, when due, all rents, charges and other amounts receivable on the owner's account in connection with the management and operation of the property. These receipts, except resident security deposits, shall be deposited in a custodial account separate from all other accounts and funds and shall be maintained with a financial institution whose deposits are insured by the Federal Deposit Insurance Corporation or any successor thereto and shall be used exclusively by the agent as funds of the property. **The agent must establish separate bank accounts for non-operating and operating activity**. Any expenses not underwritten to be paid from the property's operating account should only be paid from the non-operating checking account.

The above items are general guidance only. Each property has a unique Management Agreement that must be read to determine specific regulations for that development.

3. **Financial Spreadsheet**

The Property's Financial Spreadsheet indicates to the owner and the Management Agent how the property was underwritten. The approved operating budget of the Financial Spreadsheet should be used for guidance when preparing the first year budget. The development's staffing on the initial budget should be in accordance with the Financial Spreadsheet. Any changes in initial staffing may only be made upon the written approval of PHFA.

4. **Limited Partnership Agreement**

Partnership agreements are subordinate to the PHFA Regulatory Agreement and other PHFA legal documents. Any Partnership fees listed in this Agreement may only be paid from the property's operating account if they were originally budgeted as operating expenses on the final approved operating budget on the Property's Financial Spreadsheet. Fees not reflected on the approved budget are considered partnership expenses payable from approved return on equity.

5. **Building Loan Agreement**

The Building Loan Agreement indicates the amount of funds established at final loan closing for deposit into the tax and insurance escrow accounts. Also, the dollar amount of both the Development Contingency Fund and the Operating Reserve will be recorded in this Agreement.

It also states that the Borrower will assign to the Lender all rents, profits, income and charges it receives from the property's operations. As such, all net operating income generated from initial loan closing shall be disbursed in accordance with the terms and conditions of the Regulatory Agreement, the Support Mortgage Note, and other PHFA legal documents.

6. **Operating Deficit Fund Agreement**

The property's Owner is required to provide cash or an unconditional Letter of Credit to fund any operating deficit projected during the initial year of operations. These funds shall be held until sustaining occupancy and income, as defined below, has been achieved in two financial reporting years and additionally as determined by the Agency, in its sole discretion, upon review of future projected cash flow deficits as reflected in the property's Financial Spreadsheet in place at final loan closing and the current operating budget. The Fund may, at the Agency's sole discretion, be increased or extended at the end of each twelve (12) month financial reporting period based on a review of certified financial statements and a comparison to previously estimated operating deficits. One-half (1/2) of the undisbursed funds will revert to Owner after the achievement of the first sustaining Occupancy and Income Period. The balance of the undisbursed funds will revert to the owner after the achievement of the second Sustaining Occupancy and Income period and Agency review of projected cash flow deficits.

Sustaining Occupancy and Income shall be deemed to have been achieved when the rental income for a twelve (12) month period has paid the debt service pursuant to the Mortgages and Notes, all operating expenses (including real estate taxes at full assessment at the end of the applicable tax abatement period) and all required reserves for the period. This determination shall be made upon the review of the audited financial statements for the previous twelve (12) month fiscal period.

7. **Development Contingency Fund Agreement**

PHFA requires that the Owner establish a Development Contingency Fund (DCF) to cover any contingencies that may arise during construction and after completion of construction to provide a ready source of funds. The DCF may be held in the form of cash or an unconditional Letter of Credit. The DCF shall be held for two years after construction completion or the Agency's cost certification, whichever is later. Upon release of the DCF by the Agency, any cash deposit will be used to repay the loan to the Agency or the Letter of Credit will be returned to the Owner.

Please refer to your individual DCF Agreement for any other specific terms.

8. **Operating Deficit Reserve Agreement**

The property's owner is required to provide cash to cover ongoing operating deficits projected during the initial fifteen (15) years of operations. The amount of operating deficit reserve must include any operating deficit projected during the initial year of operations. The Agency will release funds from the reserve into the property's operating account based upon the schedule of projected deficits as reflected in the Financial Spreadsheet.

9. **Operating Reserve Agreement**

The property's Owner is required to provide cash or an unconditional Letter of Credit to fund any potential operating deficits. The minimum required reserve is an amount that is four months of projected operating expenses, reserve deposits, and amortizing debt service. The maximum reserve is nine months of projected operating expenses, reserve deposits, and amortizing debt service. These funds shall be held until achievement of two years of positive cash flow and satisfactory management and maintenance of the Project as determined by the Agency, in its sole discretion, or 15 years of Project operations, whichever is earlier. The Reserve may, at the Agency's sole discretion, be increased at the end of each twelve (12) month financial reporting period based on a review of certified financial statements and a comparison to previously estimated cash flow. If the Reserve is funded in cash, upon achievement of two years of positive cash flow and satisfactory management and maintenance of the Project as provided herein or 15 years of Project operations, whichever is earlier, any funds remaining in the Reserve will be applied to repayment of the outstanding Loan. If the Reserve is funded by posting a letter of credit, upon achievement of two years of positive cash flow and satisfactory management and maintenance of the Project as provided herein or 15 years of Project operations, whichever is earlier, the Letter of Credit will be returned to the Owner.

Please refer to your individual Operating Reserve Agreement for any other specific terms.