

MEMORANDUM

TO: Management Agents and Certified Public Accountants

FROM: Thomas F. Wolf, Portfolio Manager

DATE: January 1, 2016

SUBJECT: Procedures for the Implementation of Paragraph 6A of MassHousing's Equity Policy and the Calculation of Excess Equity

On November 9, 1999, the MassHousing Board amended the Agency's Equity Policy. For those developments that receive commitments for financing in or after December 1999, paragraph 6A stipulates:

In the event that amounts remain in the Distribution Account, as such term is defined in the Agency's standard form Regulatory Agreement ("Regulatory Agreement"), after allowable distributions have been made in accordance with the terms governing the distribution of equity set forth herein, such amounts (hereinafter "excess equity") shall be deposited in an interest bearing account maintained by the Agency, which shall be known as the "Excess Equity Account."

In the event that funds are not expended pursuant to the provisions of the escrow agreement, such funds shall become the Agency's funds and shall be used for increasing the supply of housing affordable to low income persons and families in accordance with the Act.

For developments affected by this requirement, the Massachusetts Housing Finance Agency has established a system requiring Excess Equity to be deposited with the Agency. To achieve this objective, MassHousing has defined the following points related to the timing of income recognition, the method for calculation of Excess Equity, the funding of escrow accounts, and the timing of withdrawals.

- 1) Since Excess Equity will not be escrowed by the development but rather remitted to the Agency, this amount should not be considered a component of current year's revenue. Similarly, annual interest income earned on the Excess Equity Escrow will also not be considered income of the development. Revenue should only be recognized when funds are approved for withdrawal from the Excess Equity Escrow. (See I.R.S. Letter Ruling 9451042)
- 2) The calculation of Excess Equity will be done in a manner consistent with the way HUD determines this amount, except for the calculation of the Maximum Possible Distribution Earned. MassHousing enabling legislation limits distributions to six (6) percent of Stated Equity (or the relevant percentage agreed upon by the Agency). Consequently, this number will be used to determine the Maximum Possible Distribution Earned. (See Form F.C.-6, Line 697 and Instructions)
- 3) Replacement Reserve escrows will be funded only to the extent originally permitted in the Regulatory Agreement document and in any subsequent amendments or adjustments thereto. Excess contributions to the Replacement Reserve escrow will be allowed only in those cases where there is a definable program of capital improvements that cannot be funded from current contributions and accrued interest. *Since it was MassHousing's intent that the Replacement*

Reserve Account would be used to fund major capital expenditures, the Agency reserves the right to review the sources of funding for capital items and to impute a replacement reserve withdrawal for those items deemed to have been paid inappropriately from operations.

- 4) Special Escrows will be funded only to the extent and for purposes sanctioned by the Agency.
- 5) Annual Insurance and Tax obligations will be paid from the Real Estate Tax and Insurance escrow specifically established for these purposes except for any shortfalls in funding that may be paid from the operating cash account.
- 6) The Excess equity Account shall be maintained by MassHousing subject to an escrow agreement (the “escrow agreement”) between the mortgagor and the Agency that shall provide that funds may be withdrawn solely by the Agency upon the mortgagor’s request:
 - (a) during the term of the project, for all purposes for which development Revenues may be expended pursuant to paragraph 6 of the Regulatory Agreement (or any succeeding provision governing use of Development Revenues), subject to a determination by Agency staff that the expenditure is necessary to address the project’s physical or financial needs and that no other funds are available to address such needs;
 - (b) upon prepayment or at the conclusion of the mortgage term, to extend the affordability of units available to low-income persons and families; to reduce rental charges to low-income persons and families; and to provide relocation and transitional assistance to low-income persons and families; and
 - (c) at any time, to fulfill otherwise the purposes of section 6 (c) of the Agency’s Act.

Form F.C.-6, which was amended as part of the 1999 Audit Requirements, is designed to quantify the calculation. Essentially, surplus cash will be calculated as of December 31 of each year according to the HUD formula. From surplus cash will be subtracted Distributions Earned but Unpaid. The difference, or Required Deposit to the Excess Equity Escrow, must be submitted to the Agency no later than 90 days after the close of the fiscal year (i.e. March 31) and in conjunction with the submission of the Annual Audit.

The Auditor for each development must review the calculations and provide appropriate assurances as part of the Report on Supplemental Financial Information.