

State of California
Department of Housing and Community Development
Rental Housing Development Section

Guidelines for
Physical Needs Assessments, Replacement Reserve Analysis and Replacement Reserve
Studies
with Model Contract Addendum

For all projects involving rehabilitation of existing structures, regardless of the extent of the planned construction work, the Department of Housing and Community Development (Department) requires the completion of a third-party Physical Needs Assessment (PNA) or other reliable indicators of the need for replacement reserve funds over time, acceptable to the Department (*Section 7305(b)(2)(B) of the Program regulations*). These Guidelines and the Model Contract Addendum also pertain to Replacement Reserve Analysis (RRA) and Replacement Reserve Study (RRS). The PNA, RRA or RRS will assist in the identification of immediate and long-term (i.e. the duration of the loan) rehabilitation needs and the determination of the appropriate level of replacement reserve deposits. The PNA, RRA or RRS should be performed as early as possible in the development process.

In evaluating PNAs, the Department will consider:

- a. the qualifications of the independent, third-party Property Evaluator,
- b. the extent to which the contract conforms to the attached suggested model contract addendum form, and
- c. the extent to which the PNA, RRA or RRS conforms to the standards utilized by entities experienced with financing the rehabilitation of multifamily rental housing developments. A PNA, RRA or RRS that meets the requirements of the "Fannie Mae Physical Needs Assessment Guidance to the Property Evaluator" will provide the requisite information the Department requires to conduct its evaluation.

The cost of the PNA, RRA or RRS is the responsibility of the project Sponsor and may be included in the project's development budget. The model contract addendum further defines the preparation of a PNA, RRA or RRS that includes submittal for Department approval both a draft and a final PNA, RRA or RRS.

For new construction and conversion projects, the Department may consider a reserve study (RRA or RRS), or other reliable indicators of the need for replacement reserve funds over time, acceptable to the Department. (Section 7305(b)(2)(A) of the Program regulations.) The reserve study will assist in the determination, based on the specific characteristics of the project, of the appropriate level of reserve deposits. The Department will evaluate an RRA and RRS along the lines of the aforementioned evaluation of PNAs.

Property Evaluators ("Contractor") must be licensed (or employ licensed professional(s)) as an architect, general contractor or appropriate engineer (structural or mechanical), must be an independent third party, carry professional liability insurance, and be regularly in the business of performing PNAs, (or, where applicable, reserve analysis or reserve studies) for lender or investor clients. In the absence of an appropriate professional license, the Department will consider PNA, RRA, RRS contractors that evidence experience as delineated below. Those professionals otherwise engaged in the project in question are not considered "third-party".

Contractors must be approved in advance. To obtain approval of a particular contractor (not previously approved by the Department), the project Sponsor should provide the following information to their Department loan officer:

- Contractor name, contact information and resume experience.
- Three references, preferably from lenders or investors.
- A work sample.
- Evidence of professional liability insurance.
- Evidence of a current architect, general contractor, appropriate engineer's license or evidence of multiple years' experience preparing PNAs (equivalent to those required herein) for lenders or investors.

Exhibit A, "Model Contract Addendum", provides language that should be used in whole or with only minor modifications as an attachment to, and be part of, the contract for services between the Sponsor and Contractor. Sponsor must submit the contract and addendum to the Department for review and approval prior to the commencement of work by the Contractor.

EXHIBIT A

MODEL CONTRACT ADDENDUM

THIS is an addendum to the contract dated _____, and entered into by and between:

_____ "Sponsor" and
_____ "Contractor".

As a condition for obtaining a loan from the California Department of Housing and Community Development (Department), Sponsor desires to have Contractor conduct a (choose one) for the following property:

Physical Needs Assessment

Replacement Reserve Analysis

Replacement Reserve Study

Property name: _____
Address: _____

Total Residential Units: _____

The Contractor has sufficient experience and expertise to competently conduct a multi-family housing development physical needs assessment, replacement reserve analysis, or replacement reserve study and the Contractor will perform such services for Sponsor in compliance with applicable regulations and commercially acceptable standards of the industry.

Sponsor and Contractor agree as follows:

1. Contractor's Services

A. Physical Needs Assessment

- i. Contractor will visit the above-referenced property to perform a physical needs assessment.
- ii. Contractor shall review the Sponsor's detailed scope of work or other available documentation for the proposed rehabilitation work.
- iii. Contractor shall inspect _____ units, which is _____ percent of the total number of units of the subject property. Contractor shall inspect a minimum of one (1) unit per building and all handicapped accessible units. Contractor shall provide Sponsor and the Department with a written report of each unit inspected in a summary form using the Contractor's summary forms.
- iv. On the summary forms, identify the quantity of items that need to be immediately replaced or repaired, the unit cost, and the total cost. These items include, but are not limited to: flooring, refrigerator, range, hood, dishwasher, kitchen sink, disposal, kitchen cabinets, kitchen plumbing fixtures, low flow toilets, bathroom plumbing fixtures, tubs and showers, tub and shower enclosures, smoke detectors, heating and

air conditioning units, water heaters, window treatments, closet doors, interior lighting, screens, windows, doors, GFIs, floor and window coverings and drywall repairs. Contractor shall identify any additional items in need of immediate repair.

v. Contractor shall inspect all building common areas, roof areas, mechanical systems, plumbing, and electrical systems. Where necessary, Contractor shall subcontract with a qualified specialist to evaluate major building components.

vi. Contractor shall inspect the site including drainage, asphalt, landscaping (including slope maintenance), irrigation, walkways, site lighting and security systems. Where necessary, Contractor shall subcontract with a qualified specialist to evaluate these items.

vii. Contractor shall comment on the adequacy of any work previously performed, if applicable.

viii. Contractor shall provide an evaluation without an inflation factor and one with an inflation factor. The term of the anticipated loan is 55 years.

ix. Contractor will review the building plans and specifications and all available seismic reports, structural assessments, termite and soils reports, Phase I and Phase II environmental reports, the comprehensive asbestos study, and lead paint study and formulate an opinion and make recommendations on these plans and reports for the benefit of the Department and Sponsor.

x. Contractor will keep the Department and Sponsor fully informed of the progress of the physical needs assessment, replacement reserve analysis, or replacement reserve study inspection and will discuss the contents of the draft report with the Department prior to issuance of the draft report.

xi. If applicable, the Contractor shall engage the services of reputable subcontractors to adequately evaluate building systems and identify rehabilitation costs.

xii. A PNA, RRA or RRS that meets the requirements of the "Fannie Mae Physical Needs Assessment Guidance to the Property Evaluator" is an acceptable form for the Department.

xiii. The Contractor shall be available for a three (3) hour meeting with the Department staff and Sponsor on the property site to review the draft PNA, at such time and date as is mutually acceptable to Contractor, the Department and Sponsor.

xiv. The Contractor shall be available for a two (2) hour meeting at the Department's Sacramento location, property site or Sponsor's office (at the election of the Department) for a meeting with the Department staff and the Sponsor to review the final PNA, RRA or RRS.

B. Physical Needs Assessment, Replacement Reserve Analysis or Replacement Reserve Study

At the completion of the PNA, RRA or RRS, Contractor shall provide a report in a form acceptable to the Department. Such report shall include:

i. A narrative of Contractor's findings, opinions, recommendations and comments along with photographs regarding the physical needs assessment inspection.

ii. Unit-by-unit inspection findings.

iii. A summary of the site and conditions found.

iv. A summary of the immediate Physical Needs identified including the: (1) quantity, (2) unit cost, (3) total cost and (4) comments about each item. If a subcontractor is necessary to establish costs on major systems, a summary of the subcontractor's work product shall be included in the report.

v. A summary of the Physical Needs Over Time, including the: (1) quantity, (2) unit cost, (3) total cost and (4) comments about each item necessary to maintain the project for the life of the loan (anticipated to be 55 years).

vi. Recommendations for future testing and/or inspections.

vii. A review, with comments, on the Sponsor's proposed scope of work and construction documents.

viii. A running replacement reserve account balance based on the expected/required annual deposits to replacement reserves, including any initial deposits, and annual withdrawals from replacement reserves necessary to maintain a positive replacement reserve account balance while addressing the annual physical needs over the term of the loan.

The Contractor must ensure that the PNA, RRA or RRS is comprehensive and includes all information needed for the determination of adequate deposits to replacement reserves based on industry standards taken together with project-specific characteristics, conditions and systems.

Contractor shall submit copies of the draft and final reports in a manner that allows for reproduction (without permanent binding) to the Department and the Sponsor at:

HCD: Department of Housing and Community Development
Rental Housing Development Section
Attention: *Loan Officer*
P.O. Box 952054, MS 460-1
Sacramento, California, 94252

Sponsor (enter Sponsor name and mailing address below):

Sponsor Name: _____
Address: _____

2. Due Dates

The draft report is due to HCD and Sponsor by: _____

The final report is due to HCD and Sponsor by: _____

3. Compensation

Sponsor agrees not to withhold payments for work performed in good faith.

4. Changes

No amendment or modification of the provisions of this Addendum shall be valid unless made in writing and signed by the parties hereto.

5. Time

Time is of the essence in this contract and Addendum.

WHEREFORE, the parties hereto have executed this Addendum as of the date set forth above.

Sponsor: _____
Date: _____

By: _____
Title: _____
Print name: _____

Contractor: _____
Date: _____

By: _____
Title: _____
Print Name: _____

Approved by the State of California, Department of Housing and Community Development
Date: _____

By: _____
Title: Program Manager
Print Name: _____