

**DEPARTMENT OF HOUSING AND COMMUNITY DEVELOPMENT****DIVISION OF STATE FINANCIAL ASSISTANCE****ASSET MANAGEMENT AND COMPLIANCE BRANCH**

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**ASSET MANAGEMENT AND COMPLIANCE****ADMINISTRATIVE NOTICE****Fiscal Section****Notice Number: 25-04**

**DATE:** April 21, 2025

**TO:** Sponsors, Borrowers, and Management Agents of Rental Projects  
Directly Funded by HCD

**FROM:** Raymond Victor, Section Chief, Asset Management & Compliance Branch

**SUBJECT:** Replacement Reserve Guideline Updates

**Administrative Note:** This Administrative Notice establishes a formal written notification of administrative guidelines that affect the operation projects funded by Department loan programs. It updates and supersedes AN 16-02. This format is used to identify, clarify, and record administrative guidelines and interpretations of public interest.

**Purpose and Background**

The purpose of the updated guidelines is to provide project Borrowers, Sponsors, and management agents of rental projects with loans or grants made directly by the Department, in which the Department is the named beneficiary, with consistent criteria for evaluating replacement reserve withdrawal requests and use of replacement reserve funds.

The Department has an interest in this subject due to its mandate to ensure the fiscal integrity, habitability, and affordability of developments over the entire term of its regulatory agreements. To preserve the availability of funds for capital improvements and more costly repair items, the Department expects small, regularly occurring repair items to be paid for with funds in the Project's operating account.

**Scope**

These guidelines apply to all rental projects that have an outstanding loan balance or regulatory agreement still in effect from any of the Department's multifamily loan or grant programs, including rental projects, mobile home parks, and group homes.

For projects also funded by the California Housing Finance Agency (CalHFA), United States Department of Agriculture – Rural Development (USDA-RD), or Department of Housing and Urban Development (HUD) 811 or HUD 202 programs, the Department may defer to these agencies' replacement reserve policies and withdrawal approvals during the time such projects are regulated by HUD, CalHFA or USDA-RD, with the exception of HOME-funded special replacement reserves.

- Once approval is obtained from the other agency, the Sponsor must send verification of such approval to HCD's AMC Fiscal Representative.

## **Eligible Uses and General Information:**

The process of requesting the withdrawal of replacement reserves to pay for project capital needs is as follows:

### **Step One:**

Analyze which items can be paid for from replacement reserves. Review the Matrix of Expenses (starting on page 6 of this Administrative Notice) and identify which items are eligible to be paid from replacement reserve funds.

### **Step Two:**

Determine whether any individual contract will need to provide a bid.

- 1) If no individual contract exceeds \$19,999, proceed with the work (except for RHCP-O projects, which must obtain HCD's prior written approval for all replacement reserve withdrawals) before submitting the Replacement Reserve Withdrawal Request.
- 2) If any individual contract is between \$20,000 - \$49,999, obtain the following and submit to HCD for written approval before selecting a contractor and **before** entering into any contract or agreement or starting any work:
  - The scope(s) of work.
  - The specifications for the item(s).
  - One bid for each contract.
  - The bid must be based on equivalent specifications for the work.
- 3) If any individual contract exceeds \$50,000, obtain the following and submit to HCD for written approval before selecting a contractor and **before** entering into any contract or agreement or starting any work:
  - The scope(s) of work.
  - The specifications for the item(s).
  - Two bids for each contract.
  - The bids must be based on equivalent specifications for the work.

Retain a copy of this documentation for the Project's records and submit a copy along with the Replacement Reserve Withdrawal Request form to HCD under Step Three.

It is the Department's standard requirement that the Project employs the contractor with the lowest bid. Any deviation from this policy must be described in detail and receive the Department's written approval prior to entering a contract with the desired contractor.

If bids are not obtained, the Sponsor/Borrower should provide a written explanation addressing why the required bids were not obtained.

The Department reserves the right to reject a withdrawal request which is based on insufficient documents.

### **Step Three:**

Submit a fully completed Replacement Reserve Withdrawal Request form to HCD in Excel format. The updated form is available on the Department website at:

[combined-reserve-disbursement-request-form.xlsx](#)

- All requests are to be submitted for HCD's prior written approval at the time the funds are needed and must be submitted no later than 45 days after the fiscal year-end in which the expense was incurred.
- Include a copy of the current bank statement for the Replacement Reserve Account.
- Include copies of all invoices with vendor, item description, quantity, invoice date, invoice number, unit number (if applicable), and invoice amount. It is not necessary to submit copies of checks.
- For contracts over \$19,999, attach copies of the scope of work, job specifications, and bid(s) documentation as noted in Step Two and Step Three above.

### **Step Four:**

After receipt of HCD approval, funds may be withdrawn from the Replacement Reserve Account.

### **Step Five:**

Send a copy of the invoice once work on the bid is completed and an updated Reserve Withdrawal Request form if the original amount has changed from the initial request.

## **Timing of Reserve Request Submittals**

To avoid delays, the Department recommends the submission of quarterly or semi-annual requests rather than one large request at the end of the fiscal year. Should the Department fail to act on a request for an eligible withdrawal from the reserve accounts within 30 days of the documented receipt of the request, that request shall be deemed approved.

If the withdrawal does not contain the required information, it will be returned to the Sponsor/Borrower with a request for additional information. A new 30-day approval period will begin when the Department receives all the required information.

## **Emergency Repairs**

An emergency repair is defined as a health and safety issue for which immediate action must be taken to prevent harm to a person or extensive damage to the property. Due to the immediate nature of the situation, the Sponsor/Borrower is not required to obtain bids for jobs over \$19,999 but is encouraged to do so if doing so will not incur additional damage or put people at risk of injury.

- If relocation of residents is required, either due to the damage or to make the repairs, notify the AMC Fiscal Representative within the first business day following the emergency.
- If improvements have been made without Department approval because of an urgent need, the Sponsor/Borrower must submit the Reserve Withdrawal Request form plus

supporting documentation as soon as possible after the repair has been completed to substantiate the urgent need.

## **Property Condition Assessment and Replacement Reserve Study**

The Department strongly encourages Sponsors/Borrowers to periodically (every five years) update a Property Condition Assessment (PCA), also known as a Physical Needs Assessment (PNA) or Capital Needs Assessment (CNA), to forecast future needs, the cost of meeting these needs over time, and the amount of funds needed/available each year to cover the costs. This periodic analysis is important in long-term physical needs expense planning and allows for evaluation of the adequacy of reserve deposits.

After the initial analysis has been prepared and submitted to the Department for review, Sponsors/Borrowers should update it periodically to reflect changes in the Project's condition and the cost of replacement items. The Department requires PCA's to adhere to the Fannie Mae Instructions for Performing a Multifamily Property Condition Assessment (Version: Dec. 2022):

- For all projects, the Department may require periodic updates to the PCA for the purpose of adjusting the amount of required replacement reserve deposits.
- For projects requesting loan extensions, transfer of ownership, a new loan, or other types of project restructuring, the Department requires a PCA as a condition of approval and periodically thereafter.

In most circumstances, the Department will permit funds from the operating reserve account to be used for the preparation of the PCA's. Please follow the applicable reserve withdrawal request process prior to using any reserve funds for this purpose.

## **Replacement Reserve Balances**

The Department expects the replacement reserve to be sized according to the needs of the Project. For that reason, the Department requires that projects maintain a minimum balance in the replacement reserve account of \$1,000 per unit. When the Department approves a withdrawal that reduces the amount below the minimum, the Department may require:

- The Borrower/Sponsor submits a plan within 30 days of the Department's withdrawal approval to return the Replacement Reserves to the required minimum balance and/or;
- The Borrower/Sponsor obtain and submit an updated PCA that complies with the Fannie Mae Instructions for Performing a Multifamily Property Condition Assessment (Version: Dec. 2020). Form 4099 Instructions for Performing a Multifamily Property Condition Assessment.

The Department will decide of the adequacy of the Replacement Reserve balance, annual deposits, and the plan and/or PCA submitted by the Sponsor/Borrower, and the Department may require:

- The Project to increase the amount of annual Replacement Reserves deposited from Operating Income and/or

- Reserves the right to require deposit to the Replacement Reserve account with positive cash flow, even to the extent of the Project forgoing Distributions.

### **Projects With Negative Cash Flow**

When the expense required by the Matrix to be paid from the operating account will result in a negative cash flow for the Project and there are inadequate operating reserves available, the Department will consider a request for withdrawal from the Replacement Reserve.

### **Additional Information**

Given the variety of Department programs and the fiscal and physical condition of the projects, there may be instances where the provisions in these guidelines cannot be implemented. If that is the case, please contact the Project's AMC Fiscal Representative to discuss the situation and obtain further guidance. If assistance is needed in identifying the AMC Fiscal Representative, please send an email to [AMCBranch@hcd.ca.gov](mailto:AMCBranch@hcd.ca.gov).

The following Matrix of Expenses table differentiates between expenses that should be accounted for as a "Capital Expense" (which is eligible to be paid from the replacement reserve) versus a "maintenance expense" (which must be paid from the operating account). This information should be noted in the Project's Annual Report and Audit submittal.

<b>Categories</b>	<b>Eligible expenses to be paid from the HCD Replacement Reserve Account</b>	<b>Maintenance expenses that must be paid from the HCD Operating Reserve Account</b>
<b>Appliances</b>		
Range, Hood, Refrigerator, Washer & Dryer, Garbage Disposal, Dishwasher, Microwave	Any replacement of a built-in appliance (If Project keeps an inventory of appliances for future repairs/replacement, it should not exceed two each)	Replacing or repairing components (burners, bibs, elements, controls, valves, wiring)
<b>Cabinets &amp; Countertop</b>		
Kitchen & Bathroom	Replacement	Repairs, refinishing, component & hardware replacement
<b>Flooring</b>		
Units and Common Area	Any replacement	Repairs, patching, shampooing & cleaning
<b>Doors</b>		
Exterior and Interior	Any interior or exterior door replacement	Any door repair or hardware replacement, keys, or locksmith
<b>Electrical</b>		
Fixtures, including lighting	Replacement of fixtures for an entire building (or an entire exterior area) or as part of Project remodel	Replacement of individual fixtures, repairs, parts replacement, light bulbs, switch plates, etc.
Security and Alarm Systems	New or Replacement System	System Repairs
Wiring and Electric Panels	Major electrical work or rewiring	Repairs
<b>Elevators</b>	Professional repairs or replacement	Routine maintenance and inspections
<b>Fire Extinguishers, Fire Sprinkler Systems, Smoke and CO2 Detectors</b>	Replacement or installation of fire suppression devices (except fire extinguishers) and systems	Recharging of fire extinguishers, inspections, and repairs of sprinkler heads
<b>Furniture</b> (Common Areas and Owner-Furnished Within Units)	Replacement in living units if furnished by the owner	Repairs including cleaning, replacement in common areas
<b>HVAC</b> - Heating, Ventilation, Air Conditioning, Including Boilers & Furnaces	Replacement (includes compressor) or major overhaul	Repairs, changing filters, replacement of components (such as blower motors, circuit boards, thermostats)

Categories	Eligible Expenses to be Paid from Replacement Reserves	Maintenance Expenses must be Paid from the Project Operating Account
<b>Landscape and Grounds</b>		
Exterior Walls – Retaining/Enclosure	Major replacement	Patching and repairing
Fencing and Metal Security Gates	Major replacement (20% or more), Keypad system and opening mechanism (includes motor) replacement	Patching, repair, and board replacement
Fire Hydrants (Installed/Maintained by Project)	Installation of the new fire hydrant, major replacement, or repairs (includes excavation)	N/A
Irrigation System	Replacement of irrigation system or major components (backflow, pipes)	Repairing leaks and broken sprinklers, irrigation timer (controller)
Landscaping and Walkways	Major non-routine landscaping, installation of concrete walkways, rock, rubber bark, and tree replacement (if a tree is removed and the Project is planting another tree, even elsewhere on the property)	Tree removal (if not replaced), sprinkler system repairs, routine grounds maintenance (such as mulch and flowers)
Security and Metal Security Gates	Keypad system and opening mechanism (including motor) replacement	Costs of hiring and maintaining security guard(s).
Signs	Replacement of primary project sign	Minor repairs, repainting, lighting, and other signage replacement
<b>Mobile Home Park</b>		
Concrete Pad for mobile home	Preparation of mobile home lot and/or pad replacement	N/A
Meters (Electric, Gas, & Water)	Any replacement (park owned only)	N/A
Mobile Home Installation/ Demolition	Installation (park owned only)	Demolition (resident-owned only)
Pedestals	Installation or replacement	Breakers, minor wiring issues
Shed (maintenance, resident shed, if required by the park)	Installation of the shed may include a concrete pad (resident-owned sheds ineligible)	Minor repairs

Well	Installation, replacement, or major repair.	Minor repairs
<b>Categories</b>	<b>Eligible Expenses to be Paid from Replacement Reserves</b>	<b>Maintenance Expenses must be Paid from the Project Operating Account</b>
<b>Other Common Areas</b>		
Maintenance Supply Items	Ineligible	Such as batteries, light bulbs, cleaning supplies, maintenance equipment, and tools
Childcare: Non-Commercial	Replacement of fixtures, major repairs	Routine maintenance and minor repairs
On-Site Rental/Management Office	Ineligible	Computer and business software (including industry interface), copier, fax machine, small office equipment, and furniture
Recreational Areas, Playgrounds and Pool	Replacement of equipment and fixtures, major repairs, and resurfacing	Routine maintenance and minor repairs
<b>Painting</b>		
Exterior	Painting an entire building or Project	Touch-up painting; graffiti removal
Interior- common areas	Entire Project only	All other interior painting
Interior- units	Entire Project only	Upon move-out, touch up
<b>Paving</b>		
Asphalt or Concrete Sidewalks, Parking Lots, & Driveways	Major repaving, resurfacing, seal coating, striping, or installation	Patching and crack sealing
<b>Plumbing</b>		
Bathtubs, Shower Enclosures, Sinks, Toilets, Water Heaters, Water Softeners (when on well water), Pumps	Any replacement. If a complete bathroom remodel may include faucets, shower curtain rods or doors, toilet paper holders, medicine cabinets, etc.	Repairs, parts replacement (includes faucets, shower curtain rods or doors, toilet paper holder, medicine cabinets)
Water, Sewer Pipes, & Septic Systems	Replacement or major repair (includes trenchless sewer pipe replacement), tree root removal, septic pump, pipes	Fixing leaks, use of cameras, pumping septic tanks, monitoring and maintaining septic tanks, chemicals, clogs and roto-cleanouts, filter replacement, valves
<b>Structures</b>		
Accessibility Features	Extensive accessibility work, ramps, railings	Minor repairs, modifications, and hardware



Categories	Eligible Expenses to be Paid from Replacement Reserves	Maintenance Expenses must be Paid from the Project Operating Account
Biohazard Clean Up (Includes removal of asbestos, mold, lead-based paint, large amounts of standing water, and bodily fluid clean up)	Any removal	If cash flow allows, it is paid first from OA; if not, then possible from OR eligible.
Elevated Walkways and Balconies	Major replacement of components	Minor repairs
Relocation Costs	Costs not covered or eligible by insurance are eligible for payment/reimbursement from the <u>Operating</u> Reserve Account.	Meals are not covered unless it is an overnight situation. See additional guidance on Relocation in the Operating Reserve Account Administrative Notice.
Roofing	Major replacement, including coating, flashing, gutters, downspouts, and eaves	Minor roof repairs, gutter cleaning, downspout, and eaves repair
Siding/Stucco	Extensive replacement	Patching, panel replacement
Solar	Startup costs, if any, panel replacement (if owned)	Maintenance (cleaning of panels) and other maintenance costs are not usually incurred by the Project if leased
Walls- Interior	Major replacement	Repairing holes
Windows	Any replacement	Repairs, hardware replacement, caulking, and sealing
Window Screens and Window Coverings	Replacement of window screens or window covering for an entire building or Project	Replacement of window screens or window coverings (blinds, shades, curtains) for less than an entire building, any hardware replacement, fixing screens
Bedbug Eradication	Ineligible for Replacement Reserve, but <u>eligible for Operating Reserve</u>	N/A
Insurance Deductible for Losses that pay for major repairs and reasonable Construction Management Fees.	Eligible	N/A