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Reserve For Replacement

By Bonitta R. Smith,

Branch Chief

Reserve for Replacement

Reserve for Replacement serves as a source of funds for various expenditures and is generally used to help defray the costs of replacing a project's capital items.

Reserves are established from project funds in anticipation of potential future expenditures or cash needs for the operation or upkeep of the property.

A *Reserve for Replacement* exists for most projects with HUD-insured, formerly coinsured, and HUD-held mortgages.

General guidance is found in [HUD Handbook 4350.1, Chapter 4](#).

Why is this important? The *Reserve for Replacement* fund is important for the sustainability of a property (e.g. future capital expenditures) and it is the responsibility of an AE or RS to ensure proper usage.

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The *Reserve for Replacement* requirements or stipulations can be found in various documents, including the following:

- *Regulatory Agreement*
- Section 8 HAP Contract
- *Use Agreement*

Supplemental information:

- *Project Capital Needs Assessment (PCNA)* – update: CNA Tool now available
- Owner Updated Reserve Schedule for Reserve Analysis

Reserve for Replacement

General Requirements:

- Disbursements require HUD's written consent via *Funds Authorizations* ([form HUD-9250](#)).
- **For HUD-insured projects**, owners shall establish or continue to maintain a reserve for replacements in a separate account with the mortgagee or in a safe and responsible depository designated by the mortgagee.
- Must be invested in an interest-bearing account. All interest earned is accrued to the account and must be kept in the account.
- *Minimum thresholds include a balance of 144 original monthly deposits or \$1,000 per unit, whichever is greater. (This requirement may vary based on Region preference)*
- Adequacy must be assessed periodically to project future demands and establish regular deposits.

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Task: *Processing a Request for Withdrawal*

Owners shall make all requests in writing and shall provide a detailed description of the work done or to be done; the description should identify the specific location including the dwelling unit (if applicable) in order to permit an inspection of the work without needing additional information about the work.

- Owners *should not* make requests for withdrawals more often than quarterly unless an emergency exists.
- Owners should make reimbursement requests during the same (project) fiscal year in which the expenditure occurred, preferably at least sixty days prior to the close of the project's fiscal year. In most cases, invoices dated over one-year of the request submission date will not be processed.

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Task: *Processing a Request (continued)*

- The typical processing time for a request, assuming all necessary paperwork is complete, is **25 days**. HUD may delay processing or refuse to process requests if an owner has not made a good faith effort to resolve outstanding issues from management reviews, physical inspections, or other HUD matters. Requests will not be processed if audited financial statements are delinquent.

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Task: Increasing Regular Deposits

Owner must make regular monthly deposits to the account. Periodically, deposits are increased. The following are circumstances where increases are required:

- Rent Adjustments via **Operating Cost Adjustments Factor (OCAF)** receive an automatic increase.
- Rent Adjustments via **Budget Based Rent Increase (BBRI)** may factor increased deposits into the operating budget.
- Reserve Deposits on Section 202 or 811 PRAC projects require the owner to submit analysis of the capital needs for the next five (5) years.
- Some new projects have Regulatory Agreements which require an incremental increase in the monthly payment annually from Years 2-10.

Table itemizing all requested items including:

- Description of replacement item or work completed
- Location or apartment number
- Vendor name
- Invoice date
- Check # / paid date
- Serial number
- Unit price,
- And indication whether item is Energy Star rate

- **Copies of Invoices/Receipts or bids, as needed**

Sample Submission Documentation – Itemized Table

RESERVE FOR REPLACEMENT REQUEST IN ACCORDANCE WITH HUD HANDBOOK 4350.1

PROJECT NUMBER: 061-35567 PROJECT NAME: Pleasantdale Apartments
MORTGAGEE: CW Capital LLC MANAGEMENT AGENT: Wingate Management Co
MONTHLY DEPOSIT TO R&R FUND: \$4,422.00 AS OF: 10/31/17
R & R BALANCE: \$339,997.07

We are requesting reimbursement of \$61,164.26 from the Reserve Replacement account of the subject property. Attached are HUD 9250 and the required Mortgagor/ Management Agent Certification in support of this request. A breakdown of the service or material purchased is as follows:

VENDOR	DESCRIPTION OF WORK	SERIAL #S	LOCATION	INVOICE		CHECK		AMOUNT
				NUMBER	DATE	NUMBER	DATE	
Rudder & Assoc.	tub/surround		419,618	79454	12/1/2016	47872	02/01/17	\$1,700.00
General Electric	refrigerator	ah750194	324	12091946	03/13/17	53448	03/29/17	\$635.81
General Electric	refrigerator	dh828414	527	12134612	04/04/17	55610	04/19/17	\$638.15
General Electric	refrigerator	gh773893	506	12178343	04/26/17	57741	05/10/17	\$638.15
General Electric	refrigerator	gh850887	625	12192532	05/03/17	59197	05/24/17	\$873.38

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Task: Suspension

Suspension *may* be granted for projects in good condition, by mutual consent, and to enhance project cash flow to avoid default or assignment of the mortgage.

- Suspension cannot exceed six (6) months.
- Subsequent or continuation requests require updated documentation to justify additional suspension time, i.e., Action Plan with assumptions.
- Mutually acceptable minimum threshold. If the balance falls below the recommended minimum threshold, deposits resume.
- Property must be in good physical condition.
- Property must remain under the same owner and be in good standing with HUD.
- For projects with new *Regulatory Agreements* (2011 or later), need to consider the requirements of underwriting before the suspension is allowed.

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Items traditionally contemplated as *eligible* for draws from this Fund include capital items such as (but not limited to):

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1. Replacement of refrigerators, ranges, and other major appliances in the dwelling units.
 2. Extensive replacement of kitchen and bathroom sinks and counter tops, bathroom tubs, water closets, and doors (exterior and interior).
 3. Major roof repairs, including major replacements of gutters, downspouts, and related eaves or soffits. NOTE: When replacing an entire roofing system, HUD encourages owners to seek energy efficient roofs and bonded roofs.
 4. Major plumbing and sanitary system repairs.
 5. Replacement or major overhaul of central air conditioning and heating systems, including cooling towers, water chilling units, furnaces, stokers, boilers, and fuel storage tanks.
 6. Overhaul of elevator systems.
 7. Major repaving/resurfacing/seal coating (sidewalks, parking lots, and driveways).

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8. Repainting of the entire building exterior.
9. Extensive replacement of siding.
10. Extensive replacement of exterior (lawn) sprinkler systems.
11. Replacement of or major repairs to a swimming pool.
12. For certain projects, requests for capital improvements or enhancements to the property could be considered. For examples, a personal computer and some associated software could be purchased, or perhaps individual air conditioning units could be added to a project that was not air conditioned when it was built, or perhaps gutters and downspouts could be added where necessary. Some improvements may be eligible if in HUD's opinion such items:
 - a. Would result in enhancing the mortgage security.
 - b. Would upgrade the property and place the property in a more favorable competitive position in the rental market.
 - c. Would be necessary to comply with changes in local, state, or federal laws.
 - d. Would not inordinately deplete the Reserve Fund, i.e., the improvement must be affordable.

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Items traditionally contemplated as *ineligible* for draws from this Fund include maintenance items such as (but not limited to):



1. Repainting of interior areas of projects.
2. Replacement of range burners, bibs, oven elements, controls, valves, wiring.
3. Replacement of dwelling unit air conditioning components.
4. Minor roof repairs, gutters, downspouts.
5. Minor paving repairs.
6. Caulking and sealing.
7. Window and screen repairs.
8. Replacement parts for appliances.
9. Purchase of maintenance tools and equipment.
10. Inspection/recharging/replacement of fire extinguishers.
11. Smoke detector batteries.
12. Electrical components such as circuit breakers switch plates, batteries.

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Task: Approving Request For Advances For Work To Be Done

When the owner's request to use funds is for work that is to be done, bids must be obtained and used to support the request.

The process of obtaining bids for the work items must still comply with outstanding instructions relating to HUD bidding and contracting procedures, including, but not limited to, identity of interest issues. The owners remain responsible for program operations and should institute reasonable controls and checks.

Once approved, withdrawals will be authorized in accordance with the conditions of the contract.

Bids needed for draw requests that exceed the following thresholds

100 units or less	\$25,000
101-250 units	\$50,000
Over 250 units	\$100,000

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Mortgage Letter 2012-25

The letter applies to all applications for mortgage insurance submitted after March 31, 2013.

- The notice provides specific guidance for the Project Capital Needs Assessment (PCNA) that is required for all refinances.
- Only the kinds and categories of items identified in the PCNA will be allowed as reserve withdrawals.
- The timing of repairs and replacements of the allowable items is not restricted to the schedule in the PCNA.
- The only exception is disbursements permitted for *emergency* and *unforeseen needs* (Section V(H)).
- All insured projects must get a new PCNA every ten years.