



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

OFFICE OF HOUSING

MEMORANDUM FOR: HUD Multifamily Staff
FHA Multifamily Mortgagees
3rd Party Needs Capital Needs Assessors
CNA e-Tool Users

JUL 30 2018

FROM: Christopher L. Seats, Deputy Assistant Secretary for Multifamily
Housing Programs, HT

SUBJECT: CNA e-Tool Clarifying Guidance on the Narratives Form,
Photography Requirements, and Sizing Reserves for Replacement

PURPOSE AND BACKGROUND:

The Capital Needs Assessment (CNA) e-Tool automates and standardizes the preparation, submission, and review of a capital needs assessment. The use of the CNA e-Tool became mandatory for FHA multifamily mortgage insurance programs starting November 1, 2017, and for all Rental Assistance Demonstration transactions and FHA multifamily asset management milestones starting February 1, 2018.

Although the system is fully operational and nearly 300 CNAs have been processed and approved using the e-Tool to date, users will benefit from clarified instructions described in this Memorandum.

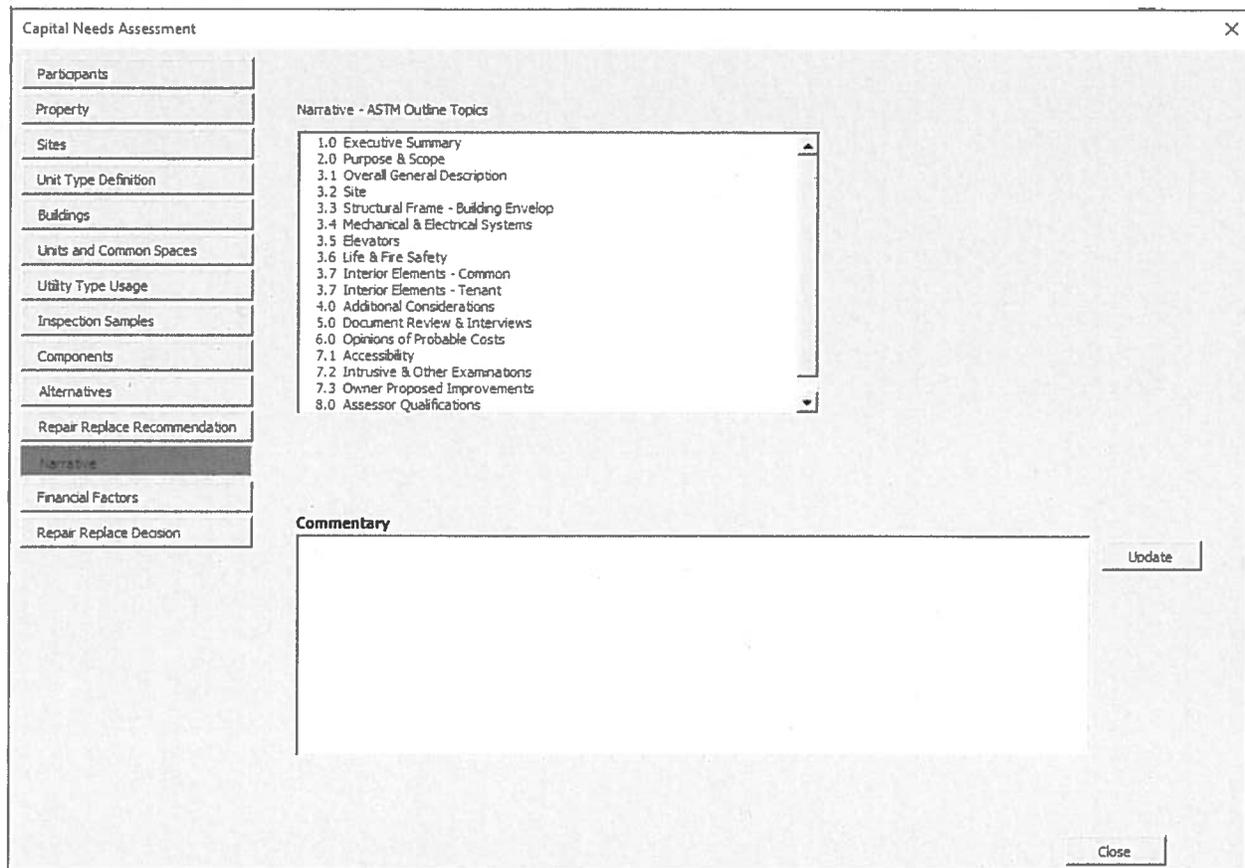
INSTRUCTION ON NARRATIVE:

The Narrative Form of the assessment tool must be used as the first means to provide salient information on applicable topics. Inapplicable sections may be left blank individually, but the entire Narrative Form unpopulated accompanied by lengthy narrative(s) attached as a separate document file(s) will not be accepted. When complex conditions require an extended explanation for a particular section, supplementary writing and documentation may be attached and should be clearly labeled for the relevant section.

For CNAs already submitted or prepared, HUD staff will continue to review narratives as submitted. Narrative entries that do not conform to this instruction will result in returned CNAs for all CNAs when:

1. The Date of Site Visit is on or after September 1, 2018 or
2. The CNA Submission Date is on or after November 1, 2018

Illustration: Narratives form of the Assessment Tool template, CNA e-Tool:



INSTRUCTION ON PHOTOGRAPHY FOR NEW CONSTRUCTION AND GUT REHABILITATION:

Photography is not required with CNAs in applications for financing new construction and gut rehabilitation. Any photography needed to illustrate site conditions prior to construction should be included as part of construction documentation apart from the CNA.

REVISED INSTRUCTION ON PHOTOGRAPHY FOR REFINANCING OR ACQUISITION OF EXISTING BUILDINGS (INCLUDING SUBSTANTIAL REHAB WHEN AND IF THE SCOPE OF WORK IS DEFINED IN THE CNA):

The 2016 MAP Guide requires annotated photography as part of a capital needs assessment for existing buildings, typically in applications for refinancing or acquisition of multifamily properties, i.e., Sections 223(f) and 223(a)(7) and for existing buildings in any application for a supplemental loan, i.e., Section 241(a). The existing instruction for photography is found in 2016 MAP Guide Appendix 5G, Section VII, subsection D.2.g on page 157. It is revised as follows with deleted words overstruck and new or added words italicized:

Annotated photography for existing properties showing the sites and buildings, unique and typical common spaces, each unit type (*but not model units used for marketing purposes*) including all rooms and baths, and typical conditions together with any photos necessary to document specific locations and/or the nature or content of immediate repairs. ~~each numbered and labeled and accompanied by such text comments as appropriate.~~ Photos of unit types *should* interiors ~~should document not only exceptional conditions (good or bad), but also actual conditions of every 5th dwelling unit inspected~~ include ~~ing~~ any common areas (hallway, breezeway, elevator) that must be transited to access the unit. *If Fair Housing Act covered units or designated UFAS accessible units are present, provide photographs of one unit of each unit type that is covered or designated. These photos should include documentation of compliance (or not) with dimensional requirements. Where distinct conditions characterize groups of units, (e.g. renovated units vs un-renovated units) provide photos of unit types of each distinct condition as though the distinct condition defined a separate unit type (e.g. 1BR/1BA renovated vs 1BR/1BA un-renovated). Annotate or label photos indicating location (building and/or unit number or location on site) as well as the description of the photographed object and relevant comments, if any.* While photos or text documents may be attached to address a particular component or topic, it is recommended that the needs assessor and/or lender assemble photography and comments in a single or multiple pdf documents organized by Need Category, i.e., by ASTM outline, e.g., 3.2 Site, 3.3 Mechanical & Electrical Systems, etc. These attachments should cover all Need Categories *identified at the property. from 3.2 through 4.0.* See the Standard Estimated Useful Life Table.

The finished revision reads as follows:

Annotated photography for existing properties showing the sites and buildings, unique and typical common spaces, each unit type (but not model units used for marketing purposes) including all rooms and baths, and typical conditions together with any photos necessary to document specific locations and/or the nature or content of immediate repairs. Photos of unit types should include any common areas (hallway, breezeway, elevator) that must be transited to access the unit. If Fair Housing Act covered units or designated UFAS accessible units are present, provide photographs of one unit of each unit type that is covered or designated. These photos should include documentation of compliance (or not) with dimensional requirements. Where distinct conditions characterize groups of units, (e.g. renovated units vs un-renovated units) provide photos of unit

types of each distinct condition as though the distinct condition defined a separate unit type (e.g. 1BR/1BA renovated vs 1BR/1BA un-renovated). Annotate or label photos indicating location (building and/or unit number or location on site) as well as the description of the photographed object and relevant comments, if any. While photos or text documents may be attached to address a particular component or topic, it is recommended that the needs assessor and/or lender assemble photography and comments in a single or multiple pdf documents organized by Need Category, i.e., by ASTM outline, e.g., 3.2 Site, 3.3 Mechanical & Electrical Systems, etc. These attachments should cover all Need Categories identified at the property. See the Standard Estimated Useful Life Table.

REVISED INSTRUCTION CLARIFYING SIZING OF RESERVES FOR REPLACEMENT

The 2016 MAP Guide was prepared and published in advance of the availability of the CNA e-Tool. Because of that absence, with publication of the MAP Guide HUD also posted the HUD R4R Financial Factors Tool 1.0, a spreadsheet provided to assist users in properly sizing Reserve for Replacement (R4R) funding consistent with Appendix 5G Section VII and subsections B.6 and C.3.d of the MAP Guide. Experience since January 2016 has demonstrated a need for a clearer description of methods that result in an acceptable R4R Financial Plan. Accordingly, relevant sections are revised as follows with deleted words overstruck and new or added words italicized:

5G VII B.6

6. Financial Factors

Estimate financial factors and variables and prepare a balanced financial plan for funding anticipated capital costs. “Balanced” in this context means that the combination of any existing Reserve for Replacement escrowed sums carried forward plus any initial and annual deposits plus periodic interest earned on balances equals or exceeds the projected capital costs plus any minimum balance requirement for ~~each of the~~ years 3 through ~~first 10 years~~ in the Estimate Period. ~~And~~ in the second ten years, any ~~negative balance deficit below the required minimum balance~~ does not exceed (in dollar amount) *half of* the cumulative amortization of the insured loan balance for the year in which the ~~negative balance deficit~~ occurs. (See “Lender’s Financial Plan” paragraph C below.)

5G VII C.3

d. Minimum Balance. When balancing the financial plan the ~~lender~~ *reserve account* must maintain an estimated minimum balance. The CNA e-Tool provides two methods for estimating the minimum balance. *Only the second one* is used for HUD purposes.

The two methods are a minimum balance as a number of dollars per unit or a minimum balance expressed as a percentage of total uninflated needs for the Estimate Period. In the latter case, the CNA e-Tool auto-calculates the percentage as the inverse of the number of years in the Estimate Period (e.g., estimate period equals "20" then minimum balance equals "1/20" or 5%). It is important that all users understand that the minimum balance is established only as a means of planning for an adequate reserve. It is not intended as a limit on disbursements as and when repair and replacement needs actually occur. The intent of the minimum balance is to provide a contingency for unanticipated costs and to trigger an asset management review when actual needs result in a remaining balance that falls below the planned minimum.

When applying the minimum balance, the lender should follow the following procedure:

(1) *Define a combination of Initial and/or Annual Deposits resulting in year-end balances that equal or exceed the required minimum balance for each of the first 10 years in the Estimate Period. When considering applications for mortgage insurance, a positive balance, but not the minimum balance is required in the first 2 years of the Estimate Period. The lender first structures the reserve for replacement schedule of initial and annual deposits based on a 10 year Estimate Period such that the 10 year schedule is balanced.*

(2) *In any year after year 10 of the Estimate Period, a remaining balance less than the minimum balance, even a negative balance, may be projected provided that the difference (a deficit) between the otherwise required minimum balance and the projected balance does not exceed 50% of the cumulative amortization of the proposed loan for the relevant year. The lender then recalculates the reserve for replacement schedule using the same values for initial and annual deposits but changing the Estimate Period to 20 years.*

(3) *The lender then observes whether any of the years 11 through 20 result in a negative balance and applies a test of whether such negative balance is a risk that must be mitigated. Mitigation is achieved by increasing the funding proposed for the reserve for replacement escrow. The test is the amount of the cumulative amortization of the proposed insured mortgage for the relative year in which the negative balance occurs. If the dollar amount of the negative balance projected deficit in any year after year 10 exceeds 50% of the cumulative amortization of the mortgage, then the negative balance deficit is excessive and must be mitigated by increasing the funding proposed for the reserve for replacement escrow.*

The finished revisions read as follows:

5G VII B.6

6. Financial Factors

Estimate financial factors and variables and prepare a balanced financial plan for funding anticipated capital costs. "Balanced" in this context means that the combination of any existing Reserve for Replacement escrowed sums carried forward plus any initial and annual deposits plus periodic interest earned on balances equals or exceeds the projected capital costs plus any minimum balance requirement for years 3 through 10 in the Estimate Period. And in the second ten years, any deficit below the required minimum balance does not exceed (in dollar amount) half of the cumulative amortization of the insured loan balance for the year in which the deficit occurs. (See "Lender's Financial Plan" paragraph C below.)

5G VII C.3

d. Minimum Balance. When balancing the financial plan the reserve account must maintain an estimated minimum balance. The CNA e-Tool provides two methods for estimating the minimum balance. Only the second is used for HUD purposes. The two methods are a minimum balance as a number of dollars per unit or a minimum balance expressed as a percentage of total uninflated needs for the Estimate Period. In the latter case, the CNA e-Tool auto-calculates the percentage as the inverse of the number of years in the Estimate Period (e.g., estimate period equals "20" then minimum balance equals "1/20" or 5%). It is important that all users understand that the minimum balance is established only as a means of planning for an adequate reserve. It is not intended as a limit on disbursements as and when repair and replacement needs actually occur. The intent of the minimum balance is to provide a contingency for unanticipated costs and to trigger an asset management review when actual needs result in a remaining balance that falls below the planned minimum.

When applying the minimum balance, the lender should follow the following procedure:

(1) Define a combination of Initial and/or Annual Deposits resulting in year-end balances that equal or exceed the required minimum balance for each of the first 10 years in the Estimate Period. When considering applications for mortgage

insurance, a positive balance, but not the minimum balance is required in the first 2 years of the Estimate Period.

(2) In any year after year 10 of the Estimate Period, a remaining balance less than the minimum balance, even a negative balance, may be projected provided that the difference (a deficit) between the otherwise required minimum balance and the projected balance does not exceed 50% of the cumulative amortization of the proposed loan for the relevant year.

(3) If the dollar amount of the projected deficit in any year after year 10 exceeds 50% of the cumulative amortization of the mortgage, then the deficit is excessive and must be mitigated by increasing the funding proposed for the reserve for replacement escrow.

Questions and comments regarding this memorandum should be directed to Thomas Bernaciak, Director of Technical Support in the Office of Multifamily Production at (202) 402-3242.