


DATE: January 9, 2014
TO: AMC Managers and Staff
FROM: Maziar Movassaghi, Assistant Deputy Director 
SUBJECT: Cash flow reduction for capital costs paid from operating account

The June 2013 joint HCD/CalHFA Audit Handbook clarified HCD's regulatory cash flow, specifically that reducing cash flow for capital costs paid from the operating account is not authorized. Routinely, funding capital costs from the operating account could jeopardize the project's ability to pay recurring operating costs and skirts the use and purpose of the Replacement Reserve account.

Sponsors may have been unaware that capital costs paid from the operating account would not reduce cash flow, which then results in higher residual receipts payments. Since the Handbook took effect mid-year, this memo serves to allow flexibility for a cash flow deduction for capital costs paid from operations within 2013 and prior years. Sponsors who have already specifically requested a capital cost deduction for 2013 and prior years for one or more of their projects should be immediately notified that this limited time capital cost deduction waiver will be granted for the project(s).

For all other projects Staff must use the Handbook, project audit and the *Manager's AR Summary* to analyze 2013 and prior year cash flow and prepare the approval letter. If a Sponsor appeals the approval letter, they must put the appeal in writing including a proposed resolution and the reason for the appeal. Once received, Staff must review the appeal with their Manager to obtain approval of a waiver for 2013.

For annual report periods after 2013, cash flow will not be reduced for capital costs paid from the project's operating account as discussed in the Handbook. A waiver may be granted if a project's Replacement Reserve account is, in the opinion of the Department, insufficient (due to low required deposits, previous withdrawals, and the like) for necessary capital repairs/replacement. Waiver requests must be in writing and include a detailed explanation for the waiver. Once received, Staff must review the waiver request with their Manager to obtain approval for waivers after 2013.

In approving the request, the Staff must evaluate and discuss the adequacy of the Replacement Reserve account including the need for a Physical Needs Assessment. Staff should remind Sponsors to consult with their accountants to develop a capitalization policy that is flexible and that conforms to Generally Accepted Accounting Principles. Staff must also remind Sponsors to adhere to the Department's Replacement and Operating Reserve policies and prudently and consistently budget each year for capital needs and improvements.