CO-OPERATIVE HOUSING FEDERATION OF CANADA

Capital reserve planning:
A guide for federal-program co-ops

VISION 2020

Getting our house in order

PART OF THE 2020 VISION TOOLKIT FOR HOUSING CO-OPS

Inside this guide

Acknowledgements

Nicholas Gazzard and Joy Connelly revised CHF Canada's 1999 *Guide to Replacement Reserve Planning* with the valuable editorial advice of Joanne Mick, Dale Reagan, Karla Skoutajan and Penelope Winter.

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1
Introduction

Why a new capital reserve planning guide?

In 1999, CHF Canada published its first edition of *A Guide to Replacement Reserve Planning*. Since then, the environment for housing co-ops has changed. Co-ops are older. Our buildings are aging faster than ever. And for many co-ops the end of their funding agreements with government is looming on the horizon.

To help our members get ready for what the future has in store, CHF Canada has launched a new initiative: the 2020 Vision Project. As the name suggests, 2020 Vision helps co-ops prepare for the time when their obligations to government come to an end. That's a job that starts now. So 2020 Vision is also about giving co-ops the tools they need today to build for the future.

This new edition of our capital reserve guide is one of those tools. It's meant to help your co-op take stock of your building's condition, and create the physical and financial plans you'll need to keep the co-op in good shape. Because if we want our co-ops to still be serving the housing needs of Canadians in 2020, we had better start laying the groundwork now.

This guide is part of the 2020 Vision Project. The guide is meant to help your co-op take stock of your building's condition, and create the physical and financial plans you'll need to keep the co-op in good shape.

Who this guide is for

This guide is for co-op members and managers. You may also want to show it to engineers and other building professionals who are helping you with capital reserve planning.

Ontario co-ops may also want to refer to another publication, *A Guide to Capital Reserve Planning*, published by SHSC Financial Inc. in 2004. That guide is designed especially for Ontario co-ops that must invest their capital reserves in the Social Housing Investment Funds managed by SHSC Financial Inc. Co-ops developed under the Homes BC program may wish to visit the BC Housing website for information on provincial guidelines.

A co-operative is an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly owned and democratically controlled enterprise.

The guide looks at why you need a capital reserve plan, how to get started, and how to hire experts to complete your plan.

What this guide will do

This guide helps you create your co-op's first capital reserve plan, or shows you how to update a plan you already have.

The guide looks at why you need a plan, how to get started, and how to hire experts to complete your plan. You'll also learn how to put your plan into action, and get some ideas for increasing the amount of money in your capital reserve fund.

We're going to explain everything in plain, non-technical language, so you won't need to be an engineer or an architect to follow the guide. You just need to be interested in the future of your co-op.

A word on terminology

Over the years, co-ops have used different words for the same thing.
In this guide:

- capital reserves means the same as replacement reserves
- capital item means the same as replacement item
- building condition assessment means the same as condition survey. It is not the same thing as a building envelope assessment.
- reserve fund forecast means the same as financial forecast.

A glossary on page 29 explains the terms used in this guide in more detail.

We'll be talking about capital items but we won't be describing them in detail. We'll also talk about investing your capital reserve but we won't go into detail in this guide.

What this guide won't do

We'll be talking about capital items in this guide, such as fridges, stoves, windows, roofs and furnaces. But we won't be describing capital items in detail. You can find a list of most capital items in Canada Mortgage and Housing Corporation's *Replacement Reserve Guide*. This guide can be downloaded from CHF Canada's website. If your program is administered by the Agency for Co-operative Housing you can also download the details of the guide from the Agency website. It's in the program guidelines section. But remember, if your co-op is not administered by CMHC, the policies in the CMHC guide will not apply to you. Check the requirements of your government program for the capital reserve rules that apply to your co-op.

We'll also talk about investing your capital reserve; getting the best possible return on investments is a key part of capital reserve planning. But we won't tell you how to do that in detail in this guide. CHF Canada plans to issue a model investment by-law, together with some advice on how to use it, that will help your co-op make sound investment choices.

2
The importance of capital reserve planning

What is a capital reserve plan?

A capital reserve plan is a management tool – one that every co-op should have.

A capital reserve plan helps you make sure you have enough money to replace roofs, windows, appliances, mechanical equipment and other capital items as they wear out. It tells you how much money you need to put into your capital reserve each year, and when you will need to spend it.

A capital reserve plan helps you make sure you have enough money to replace roofs, windows, appliances, mechanical equipment and other capital items as they wear out. It tells you how much money you need to put into your capital reserve each year, and when you will need to spend it.

A capital reserve plan is different from a maintenance budget. Your maintenance budget is part of your co-op's annual operating budget. It includes routine cleaning, preventive maintenance and repairs that you pay for each year as the need arises. Your capital reserve plan, on the other hand, shows you how to build up funds for repairs or replacements that would be too costly to pay for out of one year's revenue.

How do you know the difference between a capital repair and an ordinary maintenance repair? Capital repairs are too expensive to include in an annual budget. For example, caulking a single townhouse window would be a maintenance repair. Bringing in professionals to caulk all the windows in a high-rise would be a capital repair.

Of course, capital and maintenance budgets are closely linked. A co-op that skimps on its maintenance budget will probably find itself replacing capital items more often. In fact, a good building condition assessment will usually include advice on making capital items last longer through preventive maintenance.

The building condition assessment includes a list of all the capital items that will need to be replaced during the building's lifetime.

The reserve fund forecast tells you how much you will need to spend to cover capital repairs and replacements, projects rates of return on investments and estimates what you need to deposit into reserves to cover future costs.

The two parts of a capital reserve plan

Every capital reserve plan has two parts: a building condition assessment and a reserve fund forecast.

The building condition assessment tells you about your building's condition today. It starts with a list of all the capital items that will need to be replaced during the building's lifetime. It then estimates

- when each item will need to be replaced
- how much it would cost to replace them if the work was done today.

And as we said, it may also offer advice on extending the life of these items.

The reserve fund forecast builds on the information you collected in the building condition assessment. It tells you

- how much you'll need to spend each year on capital repairs and replacements, using today's replacement costs to estimate costs in the future
- how different rates of return on your investments will affect your reserves
- how much you should be putting into your reserves each year to cover your future costs.

Co-ops need a more realistic picture of their building's future replacement costs, and a plan for putting aside the money to pay for them. Without this information co-ops run a real risk of having their buildings break down because they don't have the means to keep them in good shape.

Why every co-op needs a capital reserve plan

More and more, co-ops are finding that the amount of money they've been putting aside in their capital reserve is not enough to meet future needs. The minimum capital reserve contributions set out by government programs have just been too low. Co-ops need a more realistic picture of their building's future replacement costs, and a plan for putting aside the money to pay for them. Without this information co-ops run a real risk of having their buildings break down because they don't have the means to keep them in good shape.

Lots of co-ops are also missing out on good investment returns from their capital reserves. That's because co-ops that don't know when they will have to spend their reserves tend to choose very short-tem investments – just in case they need money quickly. But short-term investments don't earn the returns you need to build up your reserves.

When you know when to expect major expenses, you can take advantage of longer-term, and higher-earning, investments with confidence.

So you can see why CHF Canada recommends that every co-op have a capital reserve plan. Without one, we're putting our co-op homes at risk.

Are there government policy issues that affect capital reserve planning?

Yes, there are. Co-ops administered by the Agency for Co-operative Housing operate under the same rules as they did under CMHC. For example, they have greater freedom to spend from their capital reserve fund if they have CMHC-approved replacement reserve funds. You can find out more in the CMHC *Replacement Reserve Guide* that we talked about earlier.

What about co-ops that are not administered by the Agency? Your co-op might be administered by a province, by a territory or, in the case of Ontario provincial co-ops, by one of 31 municipalities. To learn about the capital reserve planning and spending rules that apply to you, check with the government agency or department your co-op reports to.

3
Getting started

The first step in capital reserve planning is deciding to do it and budgeting for the cost. That means thinking ahead.

The role of your board

Your manager and outside consultants may well end up doing most of the work. But it's your board's job to approve the hiring of consultants, the scope of the work to be done and the contract that is put in place for the job. Your manager can help with all of that, of course, and can help you make sure you follow any program rules that apply to contract tendering at your co-op. And as with any contract the co-op enters into, your board must make sure the co-op follows its own conflict-of-interest, spending and investment by-laws. And at the other end of the line, the board needs to make sure that the plan is actually carried out!

It's your board's job to approve the hiring of consultants, the scope of the work to be done and the contract that is put in place for the job.

The board also needs to make sure that the capital reserve plan is actually carried out!

Managing the project

Capital reserve planning is a big job. It can take several months to complete. It will almost certainly involve hiring consultants – people with training and experience in capital planning – to do some of the work. The way you manage this project will depend on how you normally manage large projects. Some co-ops may appoint one or two board members, or other people with special knowledge, to join with staff to form a project team. Other co-ops place the guidance of the project in the hands of their manager.

Either way, the co-op's manager will probably be the one who actually works with hired experts to create the plan and carry out its recommendations. It's your board's job to make sure the manager has the time to do it.

However you manage the project, make sure:

- your board and project team agree on what decisions need board approval, and which decisions the team (or staff) can make themselves
- there is one person who can act as the main contact with the consultant you hire
- there is a plan to keep members informed about inspections or any other disruptions.

The co-op's manager will probably be the one who actually works with hired experts to create the plan and carry out its recommendations. It's your board's job to make sure the manager has the time to do it.

TIP:
Don't make things too complicated! If you have too many meetings or too many people involved, the job can become long and frustrating. Any project team should be able to get on with the work and simply report their progress to the board as needed.

Keep your members in the loop

The Board carries the responsibility for long-term planning – including capital reserve planning. But it's important to keep the members in the loop. Let them know the co-op is doing a plan. That way, if there's a budget decision to make later, such as increasing the amount to be set aside in your capital reserve, you're more likely to have the members on side. So get their buy-in from the beginning.

You may want to pay for the plan through your regular operating budget instead of eating even further into your reserve.

Paying for your capital reserve plan

Capital reserve planning can cost thousands of dollars, depending on the size and complexity of your building.

You can ask CMHC, your province or the Agency – depending on who's doing program administration for your co-op – if you can pay for your plan with money from your capital reserves. But that may not be the best idea. There's a good chance that when your plan is done it will show that you don't have enough money in your capital reserves to begin with. So you may want to pay for the plan through your regular operating budget instead of eating even further into your reserve.

4
How to create a capital reserve plan

Here we're going to tell you how to create the two parts of a capital reserve plan: the building condition assessment and the reserve fund forecast.

Many co-ops decide to do both parts at the same time and hire the same consultant to do all the work. The skills needed to do each part are different, but a consulting firm can often do both. You can also decide to break the work into two parts and hire a different consultant for each.

PART 1 – YOUR BUILDING CONDITION ASSESSMENT

Capital reserve planning begins with a study of the present condition of your co-op's capital items. This is called the building condition assessment.

The building condition assessment begins with a study of your building as it is now. Give your consultant as much information as you can, including:

- architectural drawings and specifications (the "as built" drawings are the most helpful)
- all existing warranties, guarantees and service contracts
- information on replacement cycles for appliances, flooring or other in-unit items
- records of capital repairs and replacements
- records of new capital items added since your co-op was built
- any planned work, including contractors' quotes if you have them
- any municipal work orders
- maintenance and inspection records – especially anything that suggests repeat problems in units
- any information that might not be spotted during an inspection. For example, a summer inspection might not reveal a heat circulation or window condensation problem.

Capital reserve planning begins with a study of the present condition of your co-op's capital items. This is called the building condition assessment.

TIP
A building condition assessment is not the same as a technical audit. Technical audits look for construction and design defects. They usually involve "destructive testing" to inspect in and behind walls and ceilings, and are much more expensive.

Next the consultant will inspect your building. There is no need to look at every single item. Unless you are doing a more complete inspection to create benchmark data for your maintenance program, a sample will do.

You may need a technical audit before the construction warranty for your building ends, or if you have had major building problems. But you won't need one just to do your capital reserve planning.

A good report should give you an opinion on your building's general condition and note any problem areas that may need in-depth testing. It should also tell you about any building code changes that will mean upgrading when you change a capital item, rather than just staying with the same quality as before.

What is in a building condition assessment report?

Now your consultant is ready to write the building condition assessment report. You should expect:

- an executive summary of the main findings
- a description of the review's scope, the methods used, the assumptions made, and definitions of the terms and standards used
- a capital item data sheet for each item setting out:
  - what the capital item is made of
  - how many of them there are
  - the condition of each item, including any unusual deficiency or abnormal wear and tear
  - their normal lifespan
  - the actual or estimated age
  - when they will next need replacing or a major repair
  - how much the replacement would cost now
  - photos that help you understand the condition of capital items
  - a summary replacement and cost schedule presented in electronic format.

A good report should give you an opinion on your building's general condition and note any problem areas that may need in-depth testing. It should also tell you about any building code changes that will mean upgrading when you change a capital item, rather than just staying with the same quality as before.

Your report should also suggest ways you can save money, such as:

- preventive maintenance practices – ways of looking after capital items to make them last longer
- less expensive replacement items that could work just as well as the original items
- where higher-quality replacements can save you money in the long run

- when it is cheaper to replace a capital item than keep on repairing it, even if the item is still working.

Finally, the report should tell you which items you need to replace or repair first. The top priority is work that protects life or safety, keeps your building structurally sound, meets new building codes, keeps equipment working well, or saves you money.

What's not in the report

Don't expect a report on every item in your building. Capital items that are meant to last the life of the building, such as foundations, won't be covered unless the consultant spots a structural problem – or you point one out.

And don't expect a discussion of routine repairs and maintenance. Your report won't talk about these things except to suggest preventive maintenance to make capital items last longer.

You can use any of the professionals your province certifies to do capital reserve plans for condominiums. Many co-ops choose to use a structural engineer who specializes in building science and building envelopes.

Who can do the building condition assessment?

Capital reserve planning is not a do-it-yourself job. You will need to hire a professional.

What kind of professional? You can use any of the professionals your province certifies to do capital reserve plans for condominiums. These professionals could include: applied science technologists, appraisers, architects, certified reserve planners, certified home inspectors, engineering technicians and technologists, professional engineers, quantity surveyors and architectural or building technologists.

Many co-ops choose to use a structural engineer who specializes in building science and building envelopes. This kind of engineer is probably the most expert in assessing the condition of capital items, and can tell you how to make them last longer and when you can expect to replace them.

Some companies provide a service that co-ordinates the work of all the specialists you will need to do a complete job.

It's a good idea to give your consultant a copy of CMHC's *Replacement Reserve Guide*. It sets out standards for replacements that are useful for all co-ops. The guide also has a very complete list of the types of capital items you're likely to find in your co-op. The guide can be downloaded from CHF Canada's website.

Your reserve fund forecast will tell you how much you will need to spend each year on capital items, after inflation, what you can expect to earn on your capital reserve savings and how much money you should be putting into your capital reserve each year to cover the cost of replacements over time.

For condominiums, the standard forecast covers 30 years. But forecasts that look ahead more than 15 years or so are often just guesses.

PART 2 – YOUR RESERVE FUND FORECAST

If the consultant does the condition survey as you've specified, the report you'll get back should give you all the information you'll need to go to the next step of the capital reserve plan: the reserve fund forecast.

What is in the financial forecast?

The financial forecast will tell you these things about your capital reserve:

- how much you will need to spend each year on capital items, after inflation
- how much you can expect to earn on your capital reserve savings
- how much money you should be putting into your capital reserve each year to cover the cost of replacements over time.

The forecast is best done using computer software designed for this purpose. CMHC has software that is suited to co-ops with federal agreements. SHSC Financial Inc. has also developed software for Ontario co-op reserve fund forecasts. Links to these and other resources can be found on the CHF Canada website. Other companies in your area may also have software that meets your needs.

How long into the future should your forecast go?

For condominiums, the standard is 30 years. But a lot can happen in 30 years. Forecasts that look ahead more than 10 years or so are often just guesses. And don't forget that your financial situation will change quite a bit when your mortgage is paid off and you can think about refinancing to pay for capital replacements (more on this later). You need to update your plan regularly to take account of changes like this. And each time you do that you add a few more years to your forecast timeline.

Many co-ops hire the consultant who prepared the building condition assessment to do the forecast as well. You can also hire an accountant, a co-op management group, or another expert in financial analysis for housing co-ops.

Who can do a reserve fund forecast?

You have some options.

Many co-ops hire the consultant who prepared the building condition assessment to do the forecast as well. The consultant already has the data on hand and may belong to a firm that offers the service. But you should make sure the consultant also has someone on staff with the skills needed for the financial analysis.

You can also hire an accountant, a co-op management group, or another expert in financial analysis for housing co-ops. Your local co-op housing federation may be able to help you find a suitable consultant. And remember, the consultant doesn't have to be located in your area. Financial forecasts are done sitting in front of a computer. As long as you provide complete information, you can choose a consultant anywhere in the country to do your capital reserve forecast.

Some co-ops may have the skills to complete the forecast in-house. CMHC's and SHSC Financial Inc.'s forecasting software is designed for anyone who can work confidently with spreadsheets. If you are thinking of doing the forecast in-house, make sure your manager has the time and skills to turn the information in the building condition assessment into a reliable reserve fund forecast.

Some co-ops may have the skills to complete the forecast in-house.

T I P

If you ask your staff to do this job, be realistic about the amount of work involved. It can take up a lot of time. That could take away staff time from other essential work for your co-op.

Your capital reserve plan is ready!

When you have your condition survey and your capital reserve financial forecast, your research is finished. Now it's time for the Board to put the plan into action.

Take time at your Board meeting not only to approve the plan but to understand it as well. The plan's success will depend on how well you integrate its findings into your budget, your investment practices and your preventive maintenance work.

It's a good idea to present the report's major findings to the members. Members don't need to approve the report. But they should know enough to prepare for any recommended housing charge increases or other changes in the way the co-op uses its money.

In the next sections we'll look at:

- putting enough money into your capital reserve to make the plan work
- carrying out your cycle of replacements and major repairs
- keeping your plan up to date.

T I P

You may need government approval for your plan. That's because under some co-op housing programs you must get approval to put more money into your capital reserve each year – and most capital reserve plans show that more money will be needed. And getting your plan approved may give you greater freedom to spend from your capital reserve. That's certainly true if CMHC or the Agency is administering your operating agreement. Again, you should check the program requirements that apply to you.

5 Hiring a consultant

The steps to hiring a consultant are similar to any hiring process. To get a good building condition assessment at the best price, we recommend the co-op invite consultants to bid on the job.

Start by preparing a Call for Bids document. This document describes the work that needs to be done, the standards that must be met (including any time limits), the qualifications you expect, how you will choose the winning bid, and the deadline for bids.

The Social Housing Services Corporation has a sample Call for Bids. Contact SHSC directly for a free copy.

Next, collect a list of qualified firms. Ask other co-ops or your local co-op federation for the names of consultants who have done work for other co-ops.

Then send your Call for Bids to the consultants on your list. Allow three to four weeks for a response. Remember: all bidders must be treated equally. Bidders should talk only to the contact person listed in the Call for Bids document. Any information given to one bidder must be given to them all.

Receive and rank the proposals. The cheapest bid may not be the best. Look for the proposal that meets all your requirements and asks a fair price for the job.

Check references. Never skip this step. Ask the consultant for names of clients with buildings like yours. Ask these references about the quality of the job and the usefulness of the report. Ask too about time or budget overruns, any failures to complete tasks, and whether they would hire this consultant again.

Hire the consultant. You'll need a written, fixed-price contract or letter of agreement. In the contract, the consultant agrees to carry out the work you ask for, at the quoted price, by a certain date; and the co-op agrees to pay the quoted price when the condition survey is presented. If the consultant is also agreeing to update the survey in the future for a set price, make sure this is included in the agreement.

The steps to hiring a consultant are similar to any hiring process. To get a good building condition assessment at the best price, we recommend the co-op invite consultants to bid on the job.

TIP
When setting a timeline for the work, be sure to allow consultants enough time to get it done properly. Sometimes the best consultants won't bid if they don't think there is enough time to do a good job.

TIP
Invite bidders to visit your co-op and take a tour before giving you a quote. That way, there won't be any disagreement later about the scope of work that's involved.

Check your consultants' work. Your consultant should prepare a draft report for your board. This is your chance to comment on the report, and make sure you can understand and use it.

T I P

Many consultants use automated reports. Make sure no information from another client has slipped accidentally into your report.

Before you sign, get proof that the consultant has liability and errors and omissions insurance. If your consultant asks you to sign their standard contract, have your lawyer review it before you sign it.

Check your consultant's work. Your consultant should prepare a draft report for your board. This is your chance to comment on the report, and make sure you can understand and use it.

It's also a chance to check your consultant's work. Watch for:

- an incorrect list of capital items. For example, the consultant may have inspected a unit with tile floors, and wrongly assumed all units had the same flooring.
- unrealistic assumptions about future maintenance standards. Good preventive maintenance can extend the life of your building, but don't assume a higher level of maintenance than you can reasonably expect.
- standards that are higher or lower than your own. The quality of flooring, appliances and cabinets can vary greatly, and so can the costs. Make sure you are making the same assumptions.
- any figures that seem unusually high or low.

6
Putting enough money into the capital reserve

If you've come this far in the process, you will know by now how much money you should be putting into the capital reserve. But what if your co-op can't afford that amount?

The best thing to do is to put aside as much as you can afford and plan to increase your contribution over time.

You're not alone. Many co-ops are in this position. The best thing to do is to put aside as much as you can afford and plan to increase your contribution over time. Here are some ways to help earn more money for your capital reserves.

Make sure your housing charges are not unnecessarily low

Some co-ops have housing charges that can't be increased very much or at all. That's because they are right at the market rate for rents in the area. But many co-ops can afford to raise housing charges without risking vacancy losses. If necessary, you can raise your housing charges closer to market levels over time to make it easier for the members to manage. But do not be shy about asking your members to pay more if it means you can look after their homes properly.

Plan to increase your capital reserve funding over time

Some co-ops plan to increase their capital reserve contributions over time by indexing them to the rate of inflation.

TIP
If you want to know more about indexing your reserve contribution, contact us here at CHF Canada.

You may be able to put more into the capital reserve in the future than you can at the moment. Doing long-term operating budget projections will help you to see what you can put in the capital reserve both now and in the years to come.

Some co-ops plan to increase their capital reserve contributions over time by indexing them to the rate of inflation – an idea borrowed from the federal ILM co-op program. Indexing means you:

- make a smaller annual contribution now
- increase the contribution each year by an amount based on the rate of inflation.

Regular inspections can spot small problems before they become big ones, and routine maintenance can extend the life of floors, decks, machinery and equipment, and other capital items.

Strengthen your maintenance program

A solid preventive maintenance program should be a top priority for any co-op. Regular inspections can spot small problems before they become big ones, and routine maintenance can extend the life of floors, decks, machinery and equipment, and other capital items. That way you won't need to replace or repair capital items as often, and your money will go further. And don't forget member education, so members know how to care for their homes and will report problems promptly.

Make sure your co-op is well managed

Some co-ops earn less revenue than they could because of vacancies or uncollected housing charges, or because their costs are higher than they need to be. If you make sure that you are managing your expenses well, keeping your co-op full and collecting all housing charges on time, you'll have more money to put into the capital reserve.

If your co-op earns an operating surplus you should think about transferring it to the capital reserve fund.

Transfer operating surpluses to the capital reserve

If your co-op earns an operating surplus you should think about transferring it to the capital reserve fund. For Section 95 co-ops, CMHC's policy for operating surpluses (or net revenues, as they are called in the guidelines) lists this as an option. Note that this policy does not apply to Section 61 and ILM co-ops. But we think it should be the first option for all co-ops. By adding any operating surplus to the reserve you are not only increasing the reserve balance, you are also going to earn more investment income.

Your reserve fund forecast may project certain "peak years" – years when many items will need replacing. If these peak years lead to temporary shortfalls, you can "flatten the peaks" by spreading out the work over several years.

Spread out the work

Your reserve fund forecast may project certain "peak years" – years when many items will need replacing. That may be because standard lifespan estimates are often multiples of four or five. Or it may just be the way the numbers add up.

If these peak years lead to temporary shortfalls, you can "flatten the peaks" by spreading out the work over several years. One caution: you may lose out on bulk discounts or savings by not having contractors complete all the work while they are on site. But on other items, spreading out the work makes sense. For example, you will get full value out of carpets that are in good shape by replacing one-fifth of unit carpets every year for five years, starting with the carpets in worst shape.

Increase investment returns

You can really increase your capital reserves by investing them wisely. That means finding the right balance between short-term deposits and longer-term investments. It also means paying attention to investment risk. Let's look more closely at ways of investing capital reserves.

Short-term deposits

Many co-ops take advantage of the Co-op Housing Interest Pool. It's important to understand that a CHIP program alone is not an investment strategy – it's a good way to manage short-term deposits but it's not a whole solution.

Your bank or credit union operating accounts are short-term deposits. They are very liquid. That means you can get hold of the funds easily. But they don't earn you much investment income.

Many co-ops take advantage of the Co-op Housing Interest Pool (CHIP) programs that are available in many regions of the country to earn a better interest on their credit union or bank accounts, but when interest rates are low, even CHIP programs won't earn your co-op much interest. And it's important to understand that a CHIP program alone is not an investment strategy – it's a good way to manage short-term deposits but it's not a whole solution.

Other kinds of short-term deposits include 30-to 90-day term deposits and 90-day treasury bills. These funds are not quite as liquid as bank accounts. You have to wait until the term expires before the funds are available. The rate of return on these short-tem investments is higher than on bank accounts, but it will still be very modest compared to returns that are possible through longer-term investing.

Longer-term investing

So before making any longer-term investment decisions, talk to a finance or investment professional about your options for longer-term investing. They will be able to advise you on the best options for your funds and on how to diversify your investments.

Your capital reserve financial forecast may show you that some of your reserves won't be needed for some time – perhaps for years. There are many investment options available for these funds, although your need to avoid investment risk will limit your choices. What do we mean by investment risk? Let's have a look.

Secure investing

Some investments carry risk; some do not. By risk, we mean that there is a danger the investment itself – the principal – could be lost, wholly or partly. Equities – shares in corporations – are an example of an investment that carries risk. Government bonds, on the other hand, do not carry risk because they are guaranteed. So are credit union or bank deposits, up to a certain limit (make sure you know what that limit is).

The tradeoff? The lower the risk, the lower the investment return is likely to be.

You'll want to invest your capital reserves wisely. You need a strategy that offers your co-op the best possible investment return and at the same time protects your original investment. The best way to do that is to choose the right combination of investments. And for that you need professional advice.

So before making any longer-term investment decisions, talk to a finance or investment professional about your options for longer-term investing. They will be able to advise you on the best options for your funds and on how to diversify your portfolio – which is a fancy way of saying don't put all your eggs in one basket.

Incentive programs can pay for work that you might otherwise pay for through your capital reserve..

Seeking out other funds

Sometimes government, municipalities or utility companies will offer grants or loans to make buildings more energy-efficient. In the past, for example, there have been government grants to replace furnaces, or loans to weatherproof buildings, with the costs paid back through savings on utility bills.

These incentive programs can pay for work that you might otherwise pay for through your capital reserve. But they change. Existing programs might get cancelled; new ones might start up. CHF Canada will be tracking these programs on behalf of our members, where they apply to housing co-ops. So watch our website.

Refinancing allows you to borrow more money and spread renovation costs over the new long-term mortgage.

Refinancing or redeveloping your property

If your co-op is facing major capital repairs or replacements that can't be funded from reserves, refinancing your property may be an option. Lots of co-ops will probably be facing refinancing after their current mortgages are paid off. But it's also possible to refinance earlier than that, depending on the government program that applies to your co-op.

Refinancing allows you to borrow more money and spread renovation costs over the new long-term mortgage. If you're thinking about refinancing once your mortgage is paid off you should plan ahead because it will have an impact on the capital work you do in the years just before you refinance. If you think you need early refinancing you should talk to CHF Canada right away.

7 Keeping the capital reserve plan up to date

A capital reserve plan will help you to predict:

- when capital items must be replaced or have major repairs done to them
- what that will cost
- how much you will earn from investing your capital reserves.

But things won't always happen according to the plan, because:

- capital items may last longer or not as long
- advances in building materials may offer savings
- the costs of replacing capital items may change
- investment earnings and inflation rates change.

That's why your capital plan needs to be adjusted as you spend from your reserve and make replacements. Keep track of replacements and their costs as you make them – you'll need this information to update your plan.

CMHC's capital reserve guide advises that capital reserve plans should be updated at least every three years to keep them current. That's good advice. Updating the capital reserve plan doesn't mean doing the condition survey all over again. Instead, it means:

- Revising the timing of replacements based on new lifespan information. Perhaps you expected to replace a number of carpets, say, in the past three years, but you replaced fewer (or more); or maybe that roof is going to last longer than you expected.
- Revising the cost of replacements based on new cost information. The costs of materials change and so does technology. Sometimes building code changes mean a standard of replacement that's different from what you expected. These things can affect the cost of replacements.
- Adding things to the list of capital items if necessary. There may be a capital item that you didn't expect would need replacing like an elevator or wiring systems; now you've learned that major work will be needed.

A capital reserve plan will help you to predict when capital items must be replaced or have major repairs done to them, what that will cost and how much you will earn from investing your capital reserves.

Your capital plan needs to be adjusted as you spend from your reserve and make replacements.

TIP
You may need technical advice from your engineer or building specialist to help you revise the schedule of replacements and their costs. And you may need help updating the financial forecast part of the capital reserve plan. But you will already have the list of capital items at your co-op from your original condition survey. And that list, with any additions, will already be built into the original financial forecast. That's why updating the plan will be a much simpler job than when you prepared it for the first time. Fine-tuning a capital reserve plan is much easier than starting from the beginning.

- Changing the forecasted balance of the capital reserve to the actual balance. When you first did your plan, your financial forecast predicted that you would have a certain amount of money in the capital reserve in three years; now you should adjust that amount to the actual balance.
- Changing the rate of investment returns and inflation rates you use in the cash forecast. Your original plan will have used expected rates of investment earnings and Consumer Price Index (CPI) changes in the cash forecast. That's the index that measures inflation. Those rates will need to be checked and updated if necessary. That way, your cash forecast will be more accurate than if you keep using the old numbers.
- Changing the amount you put into the capital reserve. Changes to your capital reserve plan will also change the amount of money you need to put in your capital reserve each year. You should check to see whether you need permission to do that under your co-op's program.

8
A final word

Getting a capital reserve plan done can seem like a big job. But if you take it step by step and follow the guidelines we've set out here, you should find it quite manageable. And planning for your capital reserve needs is one of the most important things you can do for your co-op. Our properties are getting older and more and more co-ops need to replace or repair capital items now or in the near future. The only way to know if you will have enough money to do that is to study your capital reserve needs and plan for the spending that will be needed.

Glossary

Building Condition Assessment or BCA (also known as a building condition survey) The first part of a capital reserve plan. The Building Condition Assessment report describes:

- the condition of all capital items,
- when they will probably need to be replaced
- how much the replacement would cost now, and
- what priority to give the replacement.

The assessment is based on a review of property documents and an inspection of the capital items.

Building condition survey – see Building Condition Assessment

Building Envelope Assessment – A study of the building's exterior. These studies have often been used to diagnose "leaky co-ops." They are not the same as a full building condition assessment.

Call for Bids - A way to get competitive bids to do a specific job, such as creating a capital reserve plan. Also refers to the document sent to bidders, describing the job and the terms of the competition.

Capital items – The major parts of your building, major pieces of equipment, and other property elements that you will have to replace at some time. These include:

- major building components, such as roofs, exterior walls, doors and windows, and waterproofing,
- major building services, such as heating and hot water systems, septic tanks and air handling systems,
- basic equipment, such as stoves, fridges, toilets, sinks, counters and cabinets,
- safety features, such as fire alarm systems, fire fighting equipment, emergency lighting,
- interior floors and carpeting, and
- parking lots and garages, garbage systems, intercom systems, fences, laundry equipment, water softeners for well water.

The costs of replacing capital items or major repairs are paid for out of capital reserves. Inexpensive parts, such as locks or taps, are not capital items, even though they were part of the original building. These should be replaced through your operating budget.

Capital reserve (also known as the replacement reserve) – Money the co-op puts in a fund to replace or repair major capital items. The money in the capital reserve comes from the annual or monthly transfer (capital reserve contribution) from your operating budget and any additional lump sum contributions you may make.

Capital reserve contribution – The amount of money the co-op transfers each year from its operating budget to its capital reserve. Government rules set the minimum contribution.

Capital reserve plan (also known as the replacement reserve plan) – Sometimes known as a replacement reserve plan. A capital reserve plan sets out:

- the replacement the co-op must make each year to keep its property in good repair, and
- how much money the co-op must set aside each year to pay for the replacements.

Eligible capital expenditure – The types of major repairs or replacements that can be paid for out of your capital reserve fund, as set by Canada Mortgage and Housing Corporation or other government funders.

Estimated remaining life – The time it will take before the next replacement or major repair of a capital item, assuming a normal level of maintenance.

Improvements – Capital items added to a building after the original construction.

Net operating revenue – Also known as an operating surplus. The money left when a co-op's annual operating revenues are more than its eligible operating expenses.

Replacement Reserve – see Capital Reserve

Reserve fund forecast – Also known as a reserve fund study. Part of the capital reserve plan. It builds on the information provided in the Building Condition Assessment. The Reserve Fund Forecast tells you:

- How much you will need to spend each year on capital items, and
- How much you will have available, based on projected inflation and expected earnings on investments.

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