



Chapter 6

REPLACEMENT RESERVE FUNDS

Overview

Each housing provider maintains a replacement reserve fund, under the terms of your operating agreement with BC Housing. This reserve covers the future replacement costs of appliances, flooring, furnaces, hot water tanks, carpets, linoleum, window covering, painting and paving.

The replacement reserve is funded from rent subsidies as part of your operating budget, through an annual or monthly transfer from your operating bank account to the replacement reserve accounts. The amount you transfer is set out in the operating budget and is an eligible operating expense.

Purpose

Replacement reserves are established to replace major items that periodically wear out, so the building continues to be functional over its useful life. Reserve funds are not intended to replace the building's entire structure as it reaches the end of its useful life.

Annual Provision

Replacement reserves are funded annually to ensure you have money to replace items as needed. This annual amount doesn't provide an exact accounting for each item, rather it is meant to provide a flow of funds over a number of years that allows you to replace assets as they wear out.

The annual provision is calculated before occupancy, using the original capital cost of eligible items over their estimated useful life.

a) ORIGINAL CAPITAL COST

The original capital cost is the current cost of eligible replacement reserve items at the time of occupancy. This amount is used to calculate the annual provision. Cost increases are offset by the interest earned on the replacement reserves.

b) LIFE YEARS

The term "life years" represents the estimated useful life of eligible replacement reserve items. We have developed average life years for replacement items, based on industry standards and the experience of housing providers and our staff. Life years take into account differences in use between seniors and family developments, and in some instances, differences in geographical location.



Our list of estimated life years for replacement reserve items is included in the table of eligible capital replacements on the next page. Periodically, we confirm that the estimated life years continue to represent the most current data available, and will send you the updated information if any changes occur.

c) ELIGIBLE CAPITAL REPLACEMENTS

Capital replacements are building components that wear out over time.

The replacement reserve list on the next page includes capital items with estimated life years of 5 to 25 years, and a total cost greater than \$2,500. Items funded through your operating budget, such as janitorial and maintenance equipment, are not eligible capital replacement items.

Modernization and Improvement projects are also excluded from this list. Modernization and Improvement projects include replacing and repairing major structural components of a building due to:

- Premature failure.
- Deficiencies in construction or design.
- Cosmetic or functional upgrades.
- Obsolescence of existing components.

For more information on funding for Modernization and Improvement projects, please contact your PPM or refer to the *Maintenance Guide*.

The table on the next page lists the capital replacement items you can:

- Accumulate funds for in your reserve for future replacements, and
- Use to calculate your annual provision.



STANDARDIZED LIST OF REPLACEMENT ITEMS

Including Estimated Useful Life

Category	Item	Life Years		
		Family	Seniors	Special Needs
APPLIANCES	Dishwasher	12	15	12
	Dryer	13	16	13
	Fridge	14	17	14
	Wall Oven	12	15	12
	Stove Top	12	15	12
	Stoves	12	15	12
	Washer	13	16	13
FLOORING	Carpet	5	7	5
	Linoleum/Vinyl	10	14	10
	Carpet - Common Areas	7	10	7
	Linoleum/Vinyl - Common Areas	16	20	16
HEATING	Furnace	13	16	13
	Boiler	20	20	20
	Electric Heat	20	20	20
	Hot Water Tanks	10	10	10
	Water/Oil Pumps	20	20	20
INTERIOR STRUCTURE	Air Conditioning	11	14	11
	Central Air Conditioning - Common Areas	15	20	15
	Countertops	15	20	15
PAINTING	Exterior Paint	8	8	8
	Exterior Trim Painting	8	8	8
	Interior Painting- Common Areas	5	7	5
	Interior Painting	5	7	5
PAVING	Driveways Paving	15	15	15
ROOFING	Roof	22	22	22
WINDOW COVERINGS	Blinds	7	11	7
	Drapes	8	10	8
	Awning	5	7	5
EXTERIOR STRUCTURE	Balcony Coverings	15	15	15
	Deck and Deck Coverings	10	10	10
	Fencing	10	10	10
	Playground Equipment	10	10	10
	Security Gate	15	20	15
OTHER	Fresh Water Pump	12	12	12
	Sewage/Pressure/Relay	20	20	20



Follow these steps to calculate the replacement reserve amount you need to set aside annually for each development:

- 1) From the list, enter the eligible capital replacement items applicable to your building. Include the category and description of each item, and indicate whether they are in common areas or found in each suite.
- 2) Enter the number of each item in the building, such as 20 refrigerators or 30 hot water tanks.
- 3) Enter the estimated useful life of each product.
- 4) Enter the current estimated cost for one of each item – the current unit cost.
- 5) Multiply the current unit cost by the total number of each item to get the total replacement cost.
- 6) Divide the total cost by the estimated useful life of each item to obtain the amount you need to set aside in the replacement reserve for this item, per year.
- 7) Add the reserve amounts for each item to obtain the total annual amount of your replacement reserve provision. This amount is the annual provision you need to set aside to fund eligible capital replacements, when required.

Annual Provision Adjustments

Once calculated, the annual reserve provision remains the same from year to year. This method is commonly referred to as lump sum funding.

BC Housing will periodically review the annual provision and the replacement reserve balances for each building to ensure the annual provision continues to meet, but not exceed, the funding requirements for replacement reserve expenditures. This review will be conducted as part of your financial statement review and/or operational review. If your reserve balance exceeds or does not meet current replacement requirements, we may consult you about adjusting the annual provision.

Monitoring Replacement Reserve Balances

BC Housing monitors the reserve balances of each development to ensure the annual provision is not over funding or under funding the reserves.

a) FUNDING THRESHOLD LIMITS

We use maximum and minimum ‘funding threshold limits’ to identify when reserve balances are excessive or inadequate. The funding threshold limits also indicate when specific housing providers may require additional funding and/or support for capital planning. The maximum is more than ten times the average annual provision, and the minimum is less than two times the average annual provision.



Using an average annual provision amount, currently \$60 per unit for seniors' developments and \$72 for families and special needs, we compare the balance in the reserves to the average annual provision. If the ratio between the provision balance is greater than the maximum or less than the minimum funding threshold amount, BC Housing will take steps to address possible over funding and under funding situations.

b) RESERVE OVER FUNDING AND UNDER FUNDING

We consult housing providers about the following options, when we identify possible over funding and under funding situations:

Over Funding

When a surplus of replacement reserve funds exist, the options are to:

- Stop annual funding of the reserves until the balance falls below the upper threshold limit.
- Reallocate the cash surplus to other capital programs, including Modernization and Improvement projects.

Under Funding

If a shortfall exists, the options are to:

- Provide a one-time payment, or incremental increases, to the annual provision amount, based on replacement requirements.
- Reallocate, if applicable, rent subsidy surplus funds to the replacement reserves.

Investing Replacement Reserve Funds

a) ALLOWABLE INVESTMENTS

BC Housing's replacement reserve investment policy sets out allowable investments for reserve funds from developments governed by operating agreements. The policy states that reserve funds must be funded annually and held in an investment account in the society or co-op's name. Investing reserve funds and accrued interest is limited to investments where the principal is guaranteed. Allowable investments include:

- Savings and chequing accounts, term deposits and guaranteed investment certificates of a bank, credit union or other financial institution authorized under Canadian or provincial laws to carry on trust or deposit business.
- Money market securities issued by Canadian, provincial, or U.S. governments, or agencies created by government statute and backed by the government.
- Government bonds with a minimum quality standard of BBB from a recognized rating agency.



- National Housing Act approved mortgages rated AAA and insured by CMHC.
- Housing Investment Programs sponsored by the BC Non-Profit Housing Association and Co-operative Housing Federation of BC and approved by BC Housing.

Individual holdings of corporate bonds, common or preferred stocks and mutual funds are not permitted for reserve funds, under this policy.

b) MAXIMIZING RETURNS ON INVESTMENTS

All housing providers need to develop an overall Investment Policy Statement covering your goals and time frames for managing reserve funds. Proper investment practices will ensure successful long-term management and maximize returns from your replacement reserve fund. The Investment Policy Statement should:

- Enable you to balance your requirements for future reserve expenditures with potential returns from acceptable investment vehicles.
- Include policies and procedures that ensure the investment fund is managed prudently and complies with applicable legal requirements.

Refer to [page 61-70](#) in the appendix for more information on investing replacement funds and a sample Investment Policy Statement.

Spending Reserves

a) CAPITAL REPLACEMENT PLANNING

Major capital repairs maximize the life of affordable housing units, and the value for money invested in the development. As well, timely replacements ensure residents can continue to enjoy housing that is safe and adequate.

Capital items should be replaced when they:

- No longer perform or operate as intended,
- Are no longer cost effective to maintain, or
- Present a health and safety hazard.

Regularly review the condition of capital replacement items to ensure they are performing as required, with inspections of the entire development, including individual units. Give special attention to the items included in your replacement reserve schedule.

Single items may be replaced if only one product is failing or showing excessive wear, such as a failing hot water tank. Bulk replacements may be more cost effective when the majority of one particular item, such as stoves for example, begin needing excessive repairs. You can use the life years listed on the replacement reserve schedule to estimate when particular items should be replaced. But remember that life years are an estimate and items may need to be replaced sooner or later, depending on the use and quality of the original product.



Use the information from your inspections to develop a plan for replacing items in future years. This planning will ensure required funds are available when needed, and allow you to schedule the work.

BC Housing has developed an Excel worksheet that will assist you in calculating:

- How much money you will need from the reserve funds for replacement at different times.
- How much money you will have available for capital replacements.
- How much money can be invested in medium and long-term investments, until the reserve funds are required for replacements.

A sample worksheet is included on [page 60](#) in the appendix. For more information on allocating funds for investments refer to [pages 61-65](#).

For detailed information on Capital Planning for Modernization and Improvement Projects, refer to the *Maintenance Guide*.

The Co-operative Housing Federation of BC offers a bulk purchasing program to give co-ops better prices on capital items. Call 604-879-5111 or 1-866-879-5111 for information.

b) APPROVAL FOR SPENDING RESERVE FUNDS

Spending reserve funds is limited to the replacement of items listed in the standard list of replacement reserve items. You only require prior approval from BC Housing when:

- Expenditures are not on the standard list of replacement reserve items.
- Replacement items are different in design than the original components. For example, electric baseboard heaters are being replaced with forced air furnaces.
- Replacement costs are considerably higher than the estimated replacement cost. For example, the cost of roof replacement is twice the original capital cost.
- A capital item requires replacement considerably before the estimated useful life is through. For example, the estimated useful life of the roof is 22 years, but needs replacing at 15 years.

You do not need to provide your Property Portfolio Manager with copies of the invoices for reserve expenditures, when spending is limited to eligible capital items. But your PPM may ask for copies of quotes or invoices when the replacement reserve items require BC Housing approval.



c) PAINTING AND FLOORING

You may need to replace flooring or paint units as part of the cyclical replacements from wear and tear over time, or as a result of individual move outs. Use reserve funds for all flooring and painting. While a replacement may be required earlier than anticipated from damage, the replacement cost will already be partially funded through the replacement reserve.

d) PURCHASING GUIDELINES

Although you don't require prior approval for most reserve replacements, follow the same purchasing criteria you use for spending other funds. Refer to the *Maintenance Guide* for more information on purchasing guidelines.

Reporting

All activities related to replacement reserve revenues and expenses must be disclosed on a separate statement, as part of the audited financial statements. Show each item. In addition, the auditor must include a separate report or notes to the financial statements indicating that:

- The replacement reserves have been fully funded and maintained in accordance with the operating agreement.
- All interest accruing to the fund has been recorded.

Although you aren't required to provide invoice copies for expenses, BC Housing may request additional information on your reserve expenditures for statistical purposes. We use this information to analyze useful life years and current replacement costs.

Reporting requirements for replacement reserves are included in the *Financial Reporting Requirements* supplement to this guide.