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Required Reserve Funds

Subsidy Surplus, Operating Reserve, and Replacement Reserve Funds

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CMHC  SCHL

Subsidy Surplus and Operating Reserves



Subsidy Surplus and Operating Reserve Funds

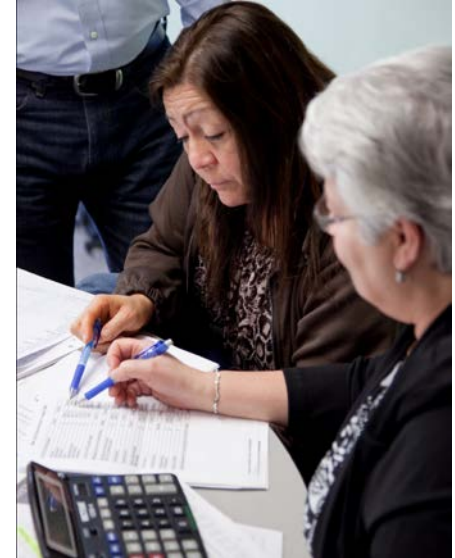


- A subsidy surplus and operating reserve fund must be established to retain operating surpluses for the project(s).
- The money in these funds can be used in future years to offset operating deficits, which occur as projects get older and operating costs rise (ex: maintenance)
- These funds are held in separate interest-bearing accounts.

Subsidy Surplus Fund—Pre-1997 Program



- Under the operating agreement, there can only be a maximum \$500 per unit in a subsidy surplus fund.
 - For example: if a project has ten units, the maximum amount of funds that can be held in a subsidy surplus fund at the end of the fiscal year is \$5,000.
- If a subsidy surplus fund has more than \$500 per unit, the excess must be returned to CMHC.



Operating Reserve Fund—Post-1996 Program



- The On-Reserve Non-Profit Housing Program (Section 95) is designed to generate surpluses in the early years; these surpluses are held in an operating reserve fund.
- These surpluses should be used to offset higher operating costs that are to be expected as the project ages.
- There is no limit to the amount of funds that can be held in an operating reserve fund.

Using the Subsidy Surplus and Operating Reserve Funds



- Prior permission is not required to use either the subsidy surplus or operating reserve fund.
- These funds can be accessed when needed to cover the cost of additional allowable expenses during a fiscal year.
- The surplus amounts can and should be considered when doing maintenance planning and budgeting for the year.

Operating Reserve Fund- An Example

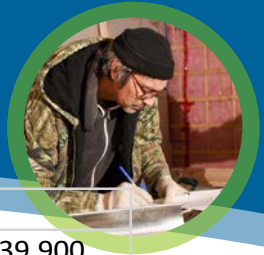


- In this example, this year's surplus was \$3,855. The surplus will be transferred to the operating reserve fund, which would be added to the accumulated balance (previous year's surpluses), if applicable, plus accumulated interest.
- Operating reserve
- Accumulated balance \$10,000
- Interest earned \$ 500
- Current year's surplus \$ 3,855
- Closing balance \$14,355

Revenue	
Housing charges	\$ 35,000
Band contribution	\$ 20,500
Subsidy (CMHC)	\$ 16,484
Other revenue	\$ -
Total revenue	\$ 71,984
Expenses	
Loan payment	\$ 40,689
Administration	\$ 8,500
Repairs and maintenance	\$ 7,500
Insurance	\$ 3,700
Allocation to replacement reserve	\$ 4,625
Garbage	\$ 1,700
Snow removal	\$ 695
Professional fees	\$ 720
Other expenses	\$ -
Total expenses	\$ 68,129
Balance (surplus/deficit)	\$ 3,855



Using the Operating Reserve Fund- An Example



- **Example:** In the subsequent year, the project experienced higher-than-planned expenses, resulting in a deficit of (\$2,630). Funds can be withdrawn from the operating reserve to fund the deficit.
- **Operating reserve**
- **Accumulated balance** \$14,355
- **Interest earned** \$ 550
- **Current year's deficit** (\$ 2,630)
- **Closing balance** \$12,275

Revenue	
Housing charges	\$ 39,900
Band contribution	\$ 20,500
Subsidy (CMHC)	\$ 16,484
Other revenue	\$ -
Total revenue	\$ 76,884
Expenses	
Loan payment	\$ 40,689
Administration	\$ 8,500
Repairs and maintenance	\$ 18,000
Insurance	\$ 3,700
Allocation to replacement reserve	\$ 4,625
Garbage	\$ 2,000
Snow removal	\$ 1,000
Professional fees	\$ 1,000
Other expenses	\$ -
Total expenses	\$ 79,514
Balance (surplus/deficit)	\$ (2,630)



Replacement Reserve Fund



Replacement Reserve Fund



- A replacement reserve is funded in a separate interest-bearing account.
- A replacement reserve allocation is identified as an expense on the income statement.
- The funds in the replacement reserve should be used to pay for the replacement of worn-out building components or for major repairs.
- Prior approval from CMHC is not required; auditors must report on the use of the funds when submitting annual audited financial statements.

Replacement Reserve Allocation – An Example



Revenue	
Housing charges	\$ 35,000
Band contribution	\$ 20,500
Subsidy (CMHC)	\$ 16,484
Other revenue	\$ -
Total revenue	\$ 71,984
Expenses	
Loan payment	\$ 40,689
Administration	\$ 8,500
Repairs and maintenance	\$ 7,500
Insurance	\$ 3,700
Allocation to replacement reserve	\$ 4,625
Garbage	\$ 1,700
Snow removal	\$ 695
Professional fees	\$ 720
Other expenses	\$ -
Total expenses	\$ 68,129
Balance (surplus/deficit)	\$ 3,855

In this example, the amount that needs to be transferred to the replacement reserve fund each year is \$4,625.



Replacement Reserve Fund- new project (example)



RR Fund	Year 1	Year 2	Year 3	Year 4	Year 5
Opening Balance	0	\$4,625	\$9,350	\$14,100	\$18,875
Interest	0	\$100	\$125	\$150	\$175
*Withdrawals	0	0	0	0	(\$550)
<u>Yearly Contribution</u>	<u>\$4,625</u>	<u>\$4,625</u>	<u>\$4,625</u>	<u>\$4,625</u>	<u>\$4,625</u>
Closing balance	\$4,625	\$9,350	\$14,100	\$18,875	\$23,125

*As the project is new, use of the replacement reserve funds is expected to be limited. Perhaps in Year 5, the housing department replaced a stove for \$550. A withdrawal of \$550 would be made to purchase the stove.



Replacement Reserve Fund



- Typically, a capital item should be replaced when it is no longer cost-effective to repair the item or when the item becomes unsafe.
- The cost of regular maintenance and repairs cannot be charged to the replacement reserve fund.
- Conversely, replacement items cannot be expensed as repairs and maintenance.

Differences Between Maintenance And Replacement Reserve Costs



Different costs



- **Replacement reserve:** replacement of capital items that are defined as major building components
- **Maintenance expenditures:** costs related to routine maintenance, servicing or repairs intended to ensure expected performance of a building component.

Not knowing the difference between both can result in a deficit in the housing program—notably, when replacement reserve items are charged to the maintenance account

Replacement Reserve Costs Charged To Maintenance Budget (example)



	RR Charged to Maintenance	Charged to RR
Rent	40,000	40,000
Subsidy	27,000	27,000
Total Revenue	67,000	67,000
Expenses		
Administration	7,250	7,250
Insurance	5,000	5,000
*Maintenance	12,404	6,254.00
Replacement Reserve Allocation	7,500	7,500.00
Mortgage Payment	38,500	38,500
Other	1,200	1,200
Total Expenses	71,854	65,704
Surplus / (Deficit)	(4,854)	1,296
*Replacement Reserve Expenditure	\$6,150	\$ -

There is a financial impact when the difference between maintenance and replacement reserve (RR) costs is not recognized.

In this example, \$6,150 was spent for capital items (windows, doors, flooring, fridge and dryer). That sum was charged to the Maintenance budget, resulting in a deficit of \$4,854.

When the sum was removed from the maintenance budget and charged to the Replacement Reserve budget, this resulted in a surplus of \$1,296.

Withdrawing funds from the Replacement Reserve



Replacement Reserve	
Opening Balance	\$12,000
Interest Earned	\$200
*Withdrawals	(\$6,150)
<u>Yearly Contribution</u>	<u>\$7,500</u>
Closing Balance	\$13,550

The \$6,150 was charged to the Replacement Reserve bank account and a withdrawal was made to cover the cost.

Replacement Reserve Fund



- When submitting audited financial statements to CMHC, the band must include an itemized list of items charged to the replacement reserve fund, including the cost of each individual item.
- Once the loan has been paid in full, any funds remaining in the replacement reserve fund will remain with the band.

Reserve Funds are essential to long-term viability



- The reserve accounts are essential to the ongoing viability and long-term viability of the Section 95 housing portfolio.
- These accounts are intended to fund future requirements—higher operating costs & capital replacement, such as roofs, doors, siding, etc.
- Not funding these accounts properly is considered a breach of the operating agreement, which could result in suspension of federal subsidy and/or ineligibility for future Section 95 housing allocations.

Thank You



*To be filled in by CMHC
staff – contact info, etc.*