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ULLETIN

Canada Mortgage and Housing Corporation

Replacement Reserve Guide

WHAT IS THE REPLACEMENT RESERVE?

The replacement reserve is a fund kept by each housing sponsor under the terms of its operating agreement with CMHC. The reserve is used to replace or repair what are known as capital items. The replacement reserve is funded from a sponsor's operating budget through an annual or monthly transfer to the reserve. The amount to be transferred, which is an eligible operating expense, is the amount set out in the operating agreement or another amount approved by CMHC.

WHAT IS THE PURPOSE OF THIS GUIDE?

This guide is intended to:

- Describe what a capital item is;
- Describe when a capital item should be replaced and what it should be replaced with;
- Explain what kinds of costs cannot be paid for from the replacement reserve;



- Provide a standard list of capital items that can be replaced or repaired using replacement reserve funds;
- Set out some extensions and variations to the standard list; and
- Set out the process for CMHC approval of spending from the reserve.

WHAT IS A CAPITAL ITEM?

There are different kinds of capital items in a housing project,

INSIDE: Everything you need to know about the Replacement Reserve

most of which have long life spans. They consist of the major building and property components, services and systems and project facilities and equipment.

Capital items generally have an expected useful lifespan that will vary according to quality and project conditions. The useful life of capital items comes to an end when the cost of repairs or maintenance is no longer worthwhile because they will not extend the useful life by a reasonable length of time.

Major repairs or renovations, the benefits of which extend beyond the current fiscal period and



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cannot easily be paid for out of annual operating budgets, can also be considered as capital items. Examples of these kinds of repairs are major roof repairs or window caulking of high-rise projects where extensive scaffolding must be erected.

WHAT IS THE LIST OF STANDARD CAPITAL ITEMS?

The following is the STANDARD LIST of capital items that can be paid for out of the replacement reserve:

a) MAJOR BUILDING COMPONENTS

- roofs, including coating, flashing, eavestrough and downspouts
- exterior wall finishes having a generally expected definite useful life expectancy that is less than the life expectancy of the project, including exterior painting and stucco
- exterior doors and windows
- exterior caulking where accessibility is a major restriction (e.g., requiring scaffolding) and the replacement is therefore a major undertaking
- above ground waterproofing including vapour barriers

b) MAJOR BUILDING SERVICES

- heating systems, including boilers (hot water or steam), forced air furnaces, radiant heat components, solid fuel burning systems, chimneys and related components



- domestic hot water tanks, booster pumps, circulating pumps and sump-pumps found in multiple unit buildings (fittings and controls replaced during the course of regular, routine maintenance are not eligible)
- septic tanks and tile beds
- required air handling systems

c) BASIC FACILITIES

- kitchen facilities such as stoves and refrigerators, sink and faucet installations, counter tops and cabinets
- bathroom facilities such as toilets, sinks and fixtures, vanities, tubs and fixtures

d) SAFETY FEATURES

- fire alarm systems such as hardwired smoke alarms, smoke and heat detectors linked to central alarm
- required fire fighting or prevention equipment
- emergency lighting

- intercom system in multiple unit buildings
- other safety items

e) OTHER MAJOR FACILITIES, EQUIPMENT AND FEATURES

- parking lot, enclosed garage, driveway and walkway surfaces including multiple unit garage surfaces and concrete slabs
- garbage disposal systems in multiple unit building (e.g., compactors, disposers)
- interior floor coverings, including common areas and suites
- exterior fences
- laundry equipment
- water softeners where hardness of well water makes these a necessity.

f) REGULATED CHANGES

- Regulatory or legislated requirements for changes that apply to existing buildings and where the authority

having jurisdiction requires replacement or upgrading within a definite period of time.

WHAT ARE THE EXTENSIONS TO THE STANDARD LIST?

Items which were designed, manufactured and installed to function and perform indefinitely but due to a construction or manufacturing deficiency or to external environmental factors, are failing or are about to fail can be added to Standard List.

Because of the variety of construction types and ages within the portfolio, some projects, such as older existing building acquisitions, may have one or more items that would be considered extensions to the Standard List.

The deficiency must be investigated and reported on by a qualified technical expert. The cost of consulting or engineering fees would be eligible for funding from the replacement reserve. Use of the replacement reserve to pay for the cost of replacement or major repair to these items must be approved by CMHC on a project specific basis. In these cases, the CMHC Branch will usually carry out a site visit.

Extensions to the Standard List can include:

- repairing foundations or significant sections of foundations
- other structural components such as wall, floor and roof framing
- brickwork, pre-cast concrete panels

- emergency generators
- retaining walls
- plumbing systems
- electrical installations including project transformers, emergency generators
- balconies

Note: Every effort should be made to determine and establish an appropriate and comprehensive project specific list at the time a capital item assessment report is prepared by or on behalf of the sponsor for inclusion in the next replacement reserve review.

WHEN SHOULD A CAPITAL ITEM BE REPLACED?

A capital item should be replaced when it is no longer performing or operating as it was meant to, no longer cost effective to maintain or no longer safe (i.e. it represents a health or safety hazard).

Some capital items are quite complex, such as moisture barriers or heating and other mechanical systems. The recommendation of a technical expert may be required to confirm that these items need replacing.

A capital item should be replaced when a change is introduced to a by-law, building code, safety standard or other government regulation that applies to a capital item in an existing residential building and upgrading of the item is mandatory and subject to a fixed deadline.

WHAT COSTS CANNOT BE PAID FOR FROM THE REPLACEMENT RESERVE?

The replacement reserve is only meant to pay for replacing capital items or for making major renovations or repairs to them. It is in no way to be construed as a fund to replace the entire project once the project has reached the end of its useful life.

Specifically, the replacement reserve is not to be used for:

- The cost of normal maintenance or repairs to keep the buildings and property in good operating condition and to preserve the expected useful life of capital items. These kinds of activities are known as routine and preventive maintenance and repairs.
- The cost of replacing building components or mechanical services that are still operating and performing satisfactorily and meet all regulatory requirements, even if they are now obsolete and would not meet building regulations and codes for new construction. Where the replacement would result in immediate operating efficiencies, for example an energy conversion retrofit that will repay the investment over a short period of time (five years), an exception would be possible.
- The costs of replacing capital items that have been damaged or destroyed as a result of deliberate abuse or vandalism.

In those cases, the sponsor should try to recover the cost of replacement should be recovered from the occupant(s) or from other persons who caused the damage, or through the sponsor's insurance policy. Where recovery is not possible replacement expenditures can be charged to the reserve.

WHAT SHOULD CAPITAL ITEMS BE REPLACED WITH?

Capital items should be replaced with ones of equivalent quality, standards of performance and expected useful life, unless it can be demonstrated that:

- a higher quality replacement is cost-effective because of lower maintenance or operating costs or a longer expected useful life; in this case, a cost benefit analysis that demonstrates the cost effectiveness (cost recovery over a period of about five years) of a higher quality replacement must be carried out; and
- the capital item being replaced is generally considered as not appropriate for the project due to proven climatic, geographic or other influences or effects.

Replacements should meet all requirements of the National Building Code, provincial codes and any other authority having jurisdiction.

WHAT ARE THE PURCHASING REQUIREMENTS?

It is recommended that the following purchasing criteria be met for replacement costs of more than \$5 000:

For costs above \$5,000 and under \$30,000: competitive prices from 3 sources through quotations, tenders or proposals

For costs above \$30,000 and under \$100,000: competitive prices from 3 sources through quotations, tenders or proposals. For construction work [see note c), below], public or invitational tender from at least three contractors/trades

For costs of \$100,000 or more: public tender for construction work in all cases or competitive bids from at least six sources
Notes to the purchasing requirements:

- a) Purchasing requirements may be met through bulk purchasing. Where bulk purchasing agreements are entered into, the following conditions apply:
 - the purchasing group must demonstrate to CMHC's satisfaction that its program is cost-effective in terms of pricing and product servicing;
 - the purchasing agreement cannot include a user fee on the part of the purchasing group and
 - the purchasing agreement must not exceed three years.

- b) Generally accepted public and invitational tendering practices must be followed and documented on file.
- c) In the context of replacing a capital item, "construction work" means work where the complexity of the work and the need for modifications to existing building components or structures would normally require specialized trades. In these circumstances, a tender package with specifications and detailed descriptions of the work involved would be required to ensure trades tender bids on the same basis.
- d) It is recognized that in some regions there may not be enough suppliers/contractors to secure competitive bids from six sources. Where that is the case, a minimum of three bids will be obtained, or a lesser number that the Branch may consider acceptable in the circumstances.

HOW ARE REPLACEMENT RESERVE EXPENDITURES APPROVED BY CMHC?

I. Sponsor has prepared a comprehensive replacement plan:

Where there is a comprehensive plan, replacement reserve expenditures do not require prior approval by CMHC, provided that:

- the plan contains a comprehensive schedule of future capital item replacements and a corresponding estimate of future replacement reserve funding requirements

- the plan has been approved by CMHC and documented in the CMHC replacement reserve worksheet
- the plan is updated no less often than every three years. CMHC will not require new technical studies to be carried out in order to update replacement reserve plans where the information previously gathered by the sponsor remains relevant and meaningful
- the expenditures are made at any point within the three year period covered by the plan, and
- any expenditures falling outside the plan which are not of an emergency nature require prior approval

Note: CMHC will accept sponsor-proposed replacement reserve cash flow estimates provided that the cash flow estimates fall within 4% of the estimates documented in CMHC's replacement reserve worksheet.



2. Sponsor has no replacement reserve plan:

Where a long-term replacement reserve plan is not in place, the sponsor will be required to obtain prior approval on expenditures not already listed in the sponsor's operating agreement with CMHC.

3. Emergency replacements:

Emergency replacements of or repairs to capital items, where delay would create a health or safety hazard. Examples include an essential building system failure, such as failure of a heating system in the winter or a structural failure that endangers the physical safety of the residents. CMHC is to be told of the emergency replacement without delay.

4. Reporting:

Sponsors are required to report annually to CMHC at the time that the audited Financial Statements are submitted, on all charges made to the replacement reserve in the preceding financial year. A detailed report is to be included as part of the audited Financial Statement showing the work that has been completed in the year and the cost of that work; this can be presented as a separate schedule, or included in the notes.