NET REVENUES IN SECTION 95 CO-OPS:

PUT THEM IN YOUR REPLACEMENT RESERVE!

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Back in 1999, after discussions with CHF Canada, Canada Mortgage and Housing Corporation approved a new policy for the treatment of net revenues in the Section 95 (formerly 56.1) federal housing co-ops. What is net revenue? It is any operating revenue left over at the end of the year, after a co-op has paid all of its annual expenses and has made its contribution to the replacement reserve and any other approved reserve that the co-op is funding.

CMHC introduced the policy because it wanted co-ops to put net revenues into reserves rather than keep them as unrestricted surpluses, which is sensible. There is more control over reserves than over unrestricted funds, as reserves have uses that are limited to the key priorities of the co op, like replacing worn out parts of the buildings or helping low-income members with their housing charges. You'll find the full text of the CMHC net revenue policy on CHF Canada's website at **www.chfcanada.coop**.

The policy sets priorities for the transfer of net revenue to reserves for Section 95 co ops. Net revenue goes first to the subsidy surplus fund, if there is "demonstrable need", though this is not defined in any way. Next it goes to special reserves approved by CMHC or the Agency for Co-op Housing, although CHF Canada is not aware of any that have been approved[1]. The next priority is a transfer to the replacement reserve. Completing the list is a transfer to any statutory reserves that may be provided for under provincial co-op acts.

In practice the choice has been between the subsidy surplus fund and the replacement reserve. After observing the outcomes of this choice for nearly nine years, CHF Canada recommends that Section 95 co-ops should always choose to transfer net revenue to the replacement reserve. Here's why.

Some co-ops have transferred net revenue to the subsidy surplus fund only to find that within a year or so they have exceeded the maximum subsidy surplus fund balance of $500 per unit net of investment earnings, and are sending money back to CMHC that could be needed in the replacement reserve.

But the replacement reserve doesn't have a maximum level. The net revenue policy says

[1] There are some co-ops with additional reserves that predate the net revenue policy's adoption. In these cases CHF Canada recommends that you either transfer these reserves to the replacement reserve if they are intended for the same purpose, or ask the Agency if they will approve them as special reserves, if they are meant for another use.

only that if the co-op's capital reserve plan shows it has more money than it needs in the replacement reserve, the contribution to the reserve will be reduced in future years. That has yet to happen. Most co-ops have the opposite problem – not enough money in the replacement reserve.

What's more, transfers of net revenues to the replacement reserve can be reversible. If a co op has a net deficit in a future year and doesn't have an accumulated surplus from earlier years to offset the deficit, it can transfer net revenue from the replacement reserve back to operations – provided of course that it has not already spent those transfers on capital replacements.

But, you might be saying, transferring net revenue to the replacement reserve won't help if our problem is a shortage of subsidy. In fact it can.

Let's think about how a co-op can have an operating deficit. Perhaps expenses turn out to be higher than expected and are exceeding revenues. Or, a co-op finds that it can't earn all of the revenue it was counting on to break even. That can happen if the co-op has unexpected vacancies, say. It can also happen if the co-op doesn't have enough subsidy to bridge the gap between the reduced housing charges that income-tested households pay and the break-even "maximum" housing charges.

That may result in an operating deficit. If it does, and there is no accumulated surplus to offset it, earlier net revenue transfers to the replacement reserve can be reversed to fill the gap between operating revenues and expenditures.

You can see how flexible net revenue transfers to the replacement reserve can be. They may be used to help pay for capital repairs and replacements, as they are part of the replacement reserve. And if they aren't spentfor that purpose, they can be used to eliminate an operating deficit, including one that is caused by a shortage of low-income subsidy, or Income-tested Assistance as it's known.

So CHF Canada's advice is pretty simple: If your Section 95 co-op earns net revenue, transfer it to the replacement reserve. It's the right decision for your co-op and for your low-income members.

For more information on this or any other matter affecting your Section 95 co-op, don't hesitate to contact us here at CHF Canada.