

Q&A

Questions and Answers on S95 Net Operating Revenue

What is net operating revenue?

In general, net operating revenue is money left over from operations, after all bills and charges have been accounted for. In a housing co-op, it's the amount that remains after the co-op has met its expenses, including the mortgage payment and replacement-reserve contribution. Your housing co-op may describe net operating revenue as the past year's operating surplus.

Why is net operating revenue of special interest to Section 95 housing co-operatives?

In 1995, CMHC began telling Section 95 (S95) co-ops that they couldn't keep all of their net operating revenue. Some part of any surplus, CMHC argued, came from the subsidy money CMHC provided to assist members of low and modest income.

Each year CMHC looked at the relationship between a co-op's net operating revenue and its income from various sources, including income-tested assistance. It then told the co-op what portion of any unspent operating funds it believed had come from the CMHC income-tested assistance. For some co-ops, this money was withheld from future subsidy payments; in other cases, co-op was expected to send CMHC a cheque.

What is the Net Operating Revenue Policy?

Co-ops disagreed with the new practice we have described and, at its members' request, the Co-operative Housing Federation of Canada took up the matter with CMHC. This action led to what is now known as the Net

Operating Revenue Policy, in effect for all fiscal years beginning after 1999. The policy applies only to S95 co-ops, although other co-ops may follow it if they wish. It tells a co-op what it should do with net operating revenue, when it has some. The policy lists several possibilities in order of priority.

What is the first priority?

If your co-op is carrying a deficit from past years, any net operating revenue goes first to reduce or wipe out that deficit. For example, if your co-op has been borrowing the money to pay its bills from member deposits, shares or loans, or from your capital replacement reserve, net operating revenue can help to set that right.

What does the Agency recommend?

If, like most co-ops, you have no accumulated deficit, we normally recommend that you add any net operating revenue to the capital replacement reserve fund. There are at least four good reasons to do this.

1. Every year co-ops tell us that they need to borrow money for capital repairs. This is not always easy to do. The net operating revenue you put in your reserve fund could mean you don't have to go to the trouble of borrowing or struggle with vacancies because you can't afford to spruce up your units.
2. All members feel pride when they live in an attractive co-op in good repair. A positive atmosphere makes for a better community.

3. Even if you are following a current reserve plan, a little extra money in this fund will be very useful if a building component fails unexpectedly.
4. Let's say that you put net operating revenue in your replacement reserve a year or two ago and this year are short of money. You can avoid a deficit by taking the net operating revenue back into operations--- provided your co-op has not already spent the money on capital work.

Are there any restrictions?

The Net Operating Revenue Policy does say that your replacement reserve can't grow beyond your co-op's future needs. These needs may be set out in an Agency-approved replacement reserve plan. If your co-op has no plan, the Agency may make its own assessment as to how much you should set aside.

However, we see few, if any, co-ops putting away too much money. Most co-ops' reserve funds are far short of what they will require. Co-op buildings are aging and many co-ops are finding it hard to maintain a reserve large enough for anticipated repairs and replacements, let alone the unexpected.

What else can a co-op do with net operating revenue?

If your co-op needs more subsidy money than it has, you may wish to put your net operating revenue into the subsidy surplus fund. This is actually the second priority under the Net Operating Revenue Policy, but only if "the need is demonstrable." The Agency will agree that your co-op needs to put net operating revenue into the subsidy surplus reserve if both of the following are true:

1. your co-op has nothing in its subsidy surplus reserve, and
2. without this contribution, your co-op's subsidy surplus reserve would be in deficit.

You may like the idea of putting your surplus here if your co-op is contributing a substantial sum from its own resources to its pool of income-tested assistance. But it is important to remember that once you transfer it to this reserve, you can use the money only for income-tested assistance. You cannot take it out later to cover an operating loss, as you could a transfer to your capital replacement reserve.

In fact, if your membership's needs change, you may not even be able to use these funds for income-tested assistance. As you know, anything in your co-op's subsidy surplus fund beyond \$500 per unit, plus interest, must go back to CMHC. That includes amounts transferred from net operating revenue.

Are there any other possibilities?

Yes, there is at least one other. If your co-op has a good reason for setting up a special reserve, you can explain your purpose to your relationship manager at the Agency. The Agency can authorize a special reserve for your co-op if we think your reason is sound.

PEI co-ops may have to treat some net operating revenue in a different way. Like all housing co-ops in Canada, they were incorporated under a provincial co-operative act. The act in PEI says that a co-op must put money from net operating revenue into a reserve. Because this is required under an act, it is known as a "statutory" reserve. The act calls for PEI co-ops to put aside 10 per cent of net operating surplus. However, acts do change from time to time. Before funding this reserve each year, we recommend that these co-ops have their property manager check to make sure that the requirement is still in force.

Do S95 co-ops ever have to send refunds to CMHC?

Yes, but those refunds are different from the refunds CMHC asked for between 1995 and 2000, although they do involve subsidy money. S95 co-ops are not required to give out every dollar of income-tested assistance they receive each year from CMHC. They can put unspent funds aside in a subsidy surplus fund for future

use, but that fund can only have so much money in it. As noted earlier, it has reached its maximum when it holds \$500 per unit, not counting interest earned and not spent. Everything over the maximum is due back to CMHC. These refunds have nothing to do with net operating revenue.

June 2016