



An Introduction to Strategic Capital Replacement Planning

Look for **MORE** in-depth information on strategic capital replacement planning in the next issue of *ACP&P*.

Effective capital replacement planning requires that a facility prioritizes its capital replacement spending, using its business model and business objectives as guidelines. With sufficient financial underwriting, facilities have the ability to proactively plan for capital replacement. Decisions to replace systems and materials may be based on drivers such as the competition in a saturated market or the needs of changing resident demographics. System efficiency, obsolescence, and failure are also drivers of buying decisions. While business models and objectives will vary greatly from facility to facility, it is crucial that each facility establish priorities to effectively plan for capital replacement investments.

Getting Started

First, outline your objectives for your capital replacement plan. Ask yourself the following questions: Are you simply trying to qualify your overall capital replacement reserve amortization? Do you want to truly assess your facility, calculate your exact spending for each year, and develop a life-term project budget? Does your board of directors want to insulate your facility from liability and determine its financial viability? Then, after conducting a thorough facility condition assessment, you should also determine your answers to what I call the “4 Rs”: Are we going to repair, renovate, reposition, or replace the building?

Facility Condition Assessments

By conducting a thorough facility condition assessment, you will be able to form a list of the improvements and replacements necessary for your facility, such as addressing deferred maintenance items, poorly executed or designed construction details, non-compliant construction details, and outdated or underperforming systems. Property owners tend to get “numb” to flaws in their facilities; they may walk past the same crack in a wall every day, and after awhile, they fail to even notice it. Meanwhile, that crack may be caused by moisture intrusion, which could eventually lead to costly mold-related issues. So it may be helpful to hire a consultant to perform your facility condition assessment. Consultants are typically able to identify areas for improvement and provide efficient and cost-effective solutions. Therefore, hiring a consultant can be “pound-wise” and can offset the cost of future improvements or repairs.

I often advise newly hired facility executives to conduct a facility condition assessment. Understanding the health of your facility’s plant is as important as understanding its financial health, particularly if you are stepping into a new environment. If problems arise early in your tenure, you may be considered at fault; if you prevent them from happening, you are the hero.

Developing Your Capital Replacement Plan

A variety of items should be included in your capital replacement plan, and the typical administrator may not immediately think of them when they put pen to paper. Administrators often overlook the fact that everything has a lifespan. For instance, you may not think that you will need a new motor-control center, because your current one has given you no problems. However, motor-control centers have a life of about 30 years, and yours may be at the end of its lifeline. On the other hand, you may budget for a brand new generator, while less expensive repairs could buy you another 10 years with your current generator. Remember that, eventually, every

component of a building will have to be replaced or maintained. You may not have to replace a brick wall, but you will certainly have to maintain it. Even sidewalks can be damaged by extreme temperatures. Those kinds of factors need to be considered when calculating your capital replacement budget. Careful examination of a system’s condition and lifecycle will aid you in planning for long-term capital replacement funding.

In addition, if you need to acquire additional funding for replacement projects via a loan or other financing, ensure that you will be able to cover the amortization of the capital replacement expenses. Create a sinking fund for the years in which considerable spending in other areas will be necessary.

Long-Term Planning

Facility executives should take a long-term view when developing their capital replacement strategy. If you do not apply a forecasting formula to each capital item in your facility, you will end up with an insufficient reserve analysis for your capital replacement fund. Additionally, look further out than 10 years. For the typical medium-size building today, 80% of replacement costs are incurred around years 10 and 20, and the major pieces of equipment have life cycles as high as 30 to 40 years. You could suddenly find yourself with tenfold unexpected expenses, with little ability to react and to procure the finances and develop the strategy to address those costs. This onslaught of costs — incurred from the need for new windows, elevators, roofs, or boilers, for example — can be a stake through the heart. So take a minimum 20-year view, looking forward as much as 40 years, to capture the depreciation of all major equipment while keeping an eye on your sinking fund and evaluating the lifecycles of your capital items. The extra effort to create a 40-year budget versus a 20-year budget is insignificant with the appropriate forecasting tools and knowledge.

As with the facility condition assessment, it may be worthwhile to partner with a consultant for the development of your capital replacement plan. It is analogous to hiring an independent accounting firm to review and certify your financials; a consultant can validate and certify your capital replacement plan.

Conclusion

In summary, first, establish the goals for your budget study analysis and create a roadmap to achieve them. Secondly, collect all of your budget data in an organized fashion, so it can be filtered to meet your reporting requirements. If you decide to work with a consultant, be sure they are knowledgeable in the areas that are important to your operations, such as environmental and structural concerns. Most importantly, work with professionals who understand the construction and renovation of senior living and health facilities and who understand the differences between the business models of for-profit versus mission-based properties, or HUD facilities versus progressive, well-financed CCRCs or assisted living facilities. By keeping these issues in mind, you have made the valuable first step in establishing a viable facility assessment and capital replacement plan. ■

John H. zumBrunnen is the president of zumBrunnen, Inc., a property consulting firm based in Atlanta (www.zumbrunnen.com). The recipient of a BS from the University of North Dakota and a member of the AAHSA Senior Leadership Council, he has 35-plus years’ experience in construction, assessment, and property development.