

# Creating a Capital Budget for Major Facility Expenses

## Why It's Critical and How to Get Started

Even with the best regular preventive maintenance, major facility systems—HVAC, roofing, parking lots, lighting and more—will reach the end of their useful lives, when further repairs are either impossible or no longer cost-effective. And when something in your facility fails unexpectedly, the cost to replace a major system can be high enough to have an impact on your annual budget.

### A CAPITAL REPLACEMENT BUDGET PREVENTS FISCAL SHOCK FROM UNEXPECTED COSTS

Creating a capital budget and reserve fund to cover scheduled replacement costs helps your business in two important ways:

- › **Minimized impact to annual budget and stabilized cash flow:** A capital reserve budget helps stabilize cash flow, minimizing the financial impact of major replacement costs;
- › **Scheduled replacement avoids higher service costs:** When immediate and unexpected breakdowns occur, significant extra costs (such as equipment rentals, overtime charges, etc.) are often incurred during emergency work. Advance planning helps to alleviate these added costs.

A capital budget, along with a dedicated reserve fund for specific needs (roofing, mechanical, lighting, parking lots, etc.) linked to the useful-service-life estimate of each, allows you to schedule for replacement as they reach the end of their lifecycle.

Paying a small amount annually into a capital reserve fund avoids the financial stress of having to pay a much larger cost for replacement in the future.

System failures can result in thousands of dollars in lost production and hours or days of employee productivity.

### BENEFITS OF CAPITAL BUDGETING FOR FACILITY SYSTEMS

- › **With a funded capital budget reserve, you apply defined amounts to the fund each year for each building system** (such as roofing, HVAC, etc.), based on an expert lifetime analysis of remaining service life. At the end of each system's expected lifetime, cash from this fund will be available to fully fund the replacement of each system, helping you avoid the negative cash flow impact of having to draw funds from operating income to cover system replacement.
- › **Pre-emptive funding of major building system replacements prevents the fiscal shock** of sudden, unexpected major expenses when something can no longer be economically repaired and must be replaced.
- › **Being proactive about replacement also prevents additional significant costs from unexpected downtime** due to lost productivity, or risk to manufacturing processes when major heating or cooling systems fail and have to be shut down. Replacement costs can run into tens of thousands of dollars on top of the potential loss in production revenue.
- › **Planned replacement prevents the extra costs of temporary equipment.** For example, since there can be weeks-long lead times for ordering major building equipment (such as chillers), temporary units must often be rented and installed to replace the equipment that failed without warning. These extra combined rental, transport, and installation costs can add significant expense beyond the final system replacement cost.



## HOW TO ESTABLISH YOUR BUILDING'S CAPITAL BUDGET AND RESERVE FUND

**Under a typical capital budgeting scenario, the remaining lifetimes of each major building system is calculated,** based on close inspection of each system by expert service technicians and incorporating ASHRAE and other industry-standards for average system life expectancy data. For example, if a building's air chiller has an estimated remaining lifetime of 15 years, with a \$275,000 system replacement cost, then the company would put \$18,333 each year into its capital reserve to fully fund replacement of this system in 15 years. This process is repeated for other systems, as well as building fixture and common area items, such as flooring (usually a 10-year service life), windows, and others subject to ongoing wear.

**For manufacturing and process companies, flexibility can also be built into these reserve funds.** For example, if revenue-generating equipment is purchased, you can divert reserve fund payments to this one-time expense for the year. Subsequent annual reserve payments can be adjusted to the fund to keep a system's scheduled replacement date on target.

## 4 STEPS TO CREATING A CAPITAL BUDGET FOR SYSTEM REPLACEMENT

1. Carefully inspect each of your building's current systems to assess the number of years remaining in their service lifetime, based on both direct inspection of each system by skilled service technicians, and referencing life expectancy guidelines for each;
2. Develop a replacement schedule to cover planned, orderly replacement of each building system and common area fixtures (such as flooring, lighting, windows, etc.) on a long term basis;
3. Calculate the amounts to be placed in reserve each year for each system, to fund its replacement on a scheduled basis at the end of its service life;
4. Establish a facility-wide maintenance plan and perform routine maintenance on all systems. Preventive maintenance must be performed as well to repair or replace key system components. Annual service costs can be accurately estimated in advance and added to the operating budget.

“ The Rudolph Libbe Group's support has allowed us to focus our time and resources on our core business while providing us the long-term budget planning needed to keep our facility operating at peak form. We've learned that the savings and efficiencies RLG brings to a company our size far outweighs the cost of an outside facility management firm. ”

Brian Leverenz  
Chief Financial Officer, Toledo Mud Hens



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