The Concept of Reserve Fund Studies

Consultation to Amendments to the Strata Property Act
1. Engineering & financial considerations
2. Legal considerations
3. Real estate considerations
4. Questions
Engineering & Financial Considerations

1. What is a Reserve Fund Study (Depreciation Report)
2. What is the Purpose of a Reserve Fund Study
3. Who is qualified to produce a Reserve Fund Study
4. How long is a Reserve Fund Study valid?
5. How much should a Reserve Fund Study cost?
6. How is a Reserve Fund Study funded?
→ In B.C. the term ‘Depreciation Report’ is already defined in the Strata Property Act (Reg.6.2).

→ In B.C., ‘Depreciation Report’ is used to describe what is nationally referred to as a ‘Reserve Fund Study’ (RFS).

→ The provincial government is developing the regulations to enact the amendments (Bill 8) to Section 94 of the Strata Property Act that contemplate mandatory Reserve Fund Studies as an option.
Depreciation report — s. 94

9 (1) The strata corporation may prepare a depreciation report estimating the repair and replacement cost for major items in the strata corporation and the expected life of those items to assist it in determining the appropriate amount for the annual contribution to the contingency reserve fund [See Reg. 6.2].

(2) A depreciation report may contain information based on the guidelines for depreciation reports as set out in the regulations and may be in the prescribed form.

Regulation 6.2 - Guidelines for depreciation report

6.2 (1) For the purposes of section 94 of the Act, a depreciation report prepared to assist a strata corporation in determining the appropriate amount for the annual contribution to the contingency reserve fund may estimate the repair or replacement cost for, and the expected life of, each of the items set out below, if applicable to the strata corporation, and any other items that the strata corporation considers should be included:

(a) the electrical system;
(b) the heating system;
(c) the plumbing system;
(d) the elevators;
(e) the exterior walls;
(f) the roof;
(g) carpeting and furnishings;
(h) interior and exterior painting.
Current Reserve Funding Thresholds in British Columbia

Should there be a minimum contribution level required?

\( \frac{3}{4} \) Vote
What is a Reserve Fund Study..?

- The art and science of anticipating and preparing for the future replacement of assets.
- A long-range financial planning tool that identifies the current status of the capital reserves and provides a funding plan to offset the anticipated future major common area replacement obligations.

Translation: A report that tells you:
- What you own
- How much money you have
- When things need to be replaced
- What it’s going to cost for future replacement
- What you can to do to pay for future replacement
Purpose of a Reserve Fund Study

→ Maintain asset value by contributing to a well-managed reserve fund  
  Translation: Keep your property value up

→ Equalize the multi-year contributions necessary to cover future replacement costs  
  Translation: Regular payments = fewer special levies

→ Develop a stable and equitable funding plan that meets the needs of current and future Owners  
  Translation: You can afford it and future owners will be able to afford it

→ Be prepared for anticipated future system deterioration and failures though proactive planning instead of reactive response  
  Translation: Plan efficiently to save time and money

→ Knowledge of the service lives and projected replacement cost of the assets  
  Translation: Understand your liabilities and when they will occur
Purpose of a Reserve Study: Move to Optimization

Purpose of a Reserve Study: Move to Optimization

- **Chaos**
  - We are confused
  - Things keep breaking
  - No one knows what is going on
  - We always seem to have lots of surprises

- **Reactive**
  - We respond after problems occur
  - We get charged more for things because we find ourselves dealing with emergencies

- **Proactive**
  - We anticipate problems
  - We prepare ahead of time
  - We are ready

- **Optimization**
  - We plan our work and we work our plan
  - We make best use of our time and resources
  - We have achieved a state of equilibrium
  - We have achieved financial stability

Maturity vs. Time Graph:

- **Chaos**
- **Reactive**
- **Proactive**
- **Optimization**

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Components of the Reserve Study

→ Physical Analysis (how long do thing last?)
  → Component inventory
  → Condition review of the assets
  → Effective Age of the assets
  → Estimated remaining life of the assets

→ Financial Analysis (how much do things cost?)
  → Future replacement cost of the assets
  → Current funding level
  → Inflation rate, interest rate, etc
  → Annual allocation to the reserve fund
Physical Analysis - Asset Inventory

Elev 2
Basement Traction Elevators

Location: Passenger elevators #3 and #4.

Description: Duplex operation geared traction elevators with MCE VFMC controls, Yaskawa drives, 2500 lbs capacity, speed rated at 250 fpm.

Chronological Age: 4  Service Life: 25
Effective Age: 4  Remaining Service Life: 21

General

Elev 5
Escalators - Exterior Units

Location: Units PMU and PMO at south end of facility to bus loop.

Description: Knee parallel units, glass balustrade, stainless steel/plastic deck.

Chronological Age: 2  Service Life: 35
Effective Age: 2  Remaining Service Life: 33
Samples of Building Assets

**Emergency Generator**
- 35-40 year service life
- $150,000 renewal cost
- $1,400 annual maintenance
- High-rise in Lower Mainland

**Low Slope Roof**
- 25 year service life
- $500,000 renewal cost
- $900 annual maintenance
- High-rise in Lower Mainland
Samples of Building Assets

**Hallway Carpets**
- 12-15 year typical service life
- $50,000 renewal cost
- $1,800 annual maintenance
- Low-rise in Lower Mainland

**Wood Fencing**
- 15 year service life
- $30,000 renewal cost
- $600 annual maintenance
- Townhouse in Lower Mainland
→ **Expense Model.** This model predicts future expenses by evaluating the condition of the individual asset components.
   Translation: How you *spend* money over time.

→ **Funding Model.** Once the expense model is created, this model is developed to fulfill the funding requirements.
   Translation: How you *raise* money over time.

→ **Financial Planning.** Once the money is raised, who is going to be responsible to administer and invest the funds to gain the planned amortization over the term of the study?
   Translation: How you *manage* money over time.
<table>
<thead>
<tr>
<th>Authority</th>
<th>Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>ICAO, Accounting Guidelines, s.2, p.5 (2001)</td>
<td></td>
</tr>
<tr>
<td>CCI, Reserve Funding for Condominiums</td>
<td>(2003)</td>
</tr>
<tr>
<td>AIC, Professional Appraisal Practice, line 3420</td>
<td>(2005)</td>
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Who is qualified to produce Reserve Fund Studies

Who is a qualified person..?

Professional Disciplines
→ Engineers
→ Accountants
→ Professional reserve analysts
→ Appraisers

Professional Designations in Canada
→ ARP, CRP - Real Estate Institute of Canada (REIC)

Should there be prescribed standards within the regulations for the performance requirements of a reserve fund study..?
Documents required for Reserve Studies

**Financial Documents**
- Operating budget
- Balance sheet
- General ledger
- Copies of invoices
- Insurance certificate/appraisal

**Technical Documents**
- Drawings
- Prior investigation reports
- Annual fire inspection report
- Maintenance manuals
- Maintenance logs
- Other

**Legal Documents**
- Strata Plan
- Bylaws
- Reciprocal easements
- Service agreements
- Air Parcel Agreements
- Leases and Licenses
## Assumptions in Reserve Studies

<table>
<thead>
<tr>
<th>Financial Assumptions</th>
<th>Technical Assumptions</th>
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</thead>
<tbody>
<tr>
<td>→ Inflation rate</td>
<td>→ Quality of maintenance</td>
</tr>
<tr>
<td>→ Interest rate</td>
<td>→ Concealed conditions</td>
</tr>
<tr>
<td>→ Investment rate</td>
<td>→ Service environment</td>
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<tr>
<td>→ Contingency rate</td>
<td>→ Maintenance standards</td>
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<tr>
<td>→ Force majeur (insurable losses)</td>
<td>→ Maintenance policies</td>
</tr>
<tr>
<td>→ Contractors vs. own forces</td>
<td></td>
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<tr>
<td>→ Bundling of projects</td>
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How long should a Reserve Study be valid...

How far into the future should the Owners look?

How long should our buildings last?
How long should an Reserve Study be valid..?

Concept of Intergenerational Equity
How long should a Reserve Study be valid..?

Common misconception:
Projection is for 30 years so the Reserve Study does not need to be updated for a similar period of time.
How much should a Reserve Study cost..?

Charges can vary significantly depending on:

- The scope of work – use of a multi-disciplinary team
- The size and complexity of the buildings
- Location - The consultant’s travel expenses
- Level of service requested – Type of study
How much should a Reserve Study cost?

- The cost and scale of the Reserve Fund Study should be commensurate with the size and complexity of the building.
- If we live in a 20 unit townhouse complex, does it require the same standard of a study as a 185 unit high rise with mixed commercial, pool, elevators and generator?
What are the different levels of service?

- **Initial Study (level 1)**
  - This provides for a complete review of all the major components and establishes the initial baselines. This type of study has the highest level of effort for the consulting team.

- **Update Study With Site Visit (level 2)**
  - This refines the data at periodic reviews. An update study takes the original study and updates key parameters, such as inflation rate. The study team returns to the site to collect certain information.

- **Update Study Without Site Visit (level 3)**
  - This is an off-site review. Similar to the periodic updates done to the insurance appraisal for the property where the appraiser updates the value without leaving the office.

- **Do it yourself kit (level 4)**
  - Software to enable owners to conduct their own study.
Request for proposal – scope of services?

- How the customer explained it
- How the Project Leader understood it
- How the Analyst designed it
- How the Programmer wrote it
- How the Business Consultant described it
- How the project was documented
- What operations installed
- How the customer was billed
- How it was supported
- What the customer really needed
How do we evaluate consultant proposals?

- Qualifications (ARP designation, P.Eng. etc)
- Experience
- Scope of work (what are you getting?)
- Need to be able to compare apples to apples
- Proposed methods and assumptions
- Fees

Should there be prescribed standards within the regulations for the performance requirements of a reserve study?
Basic Services Required

- Requirement to conform to published renewal plan standards (REIC).
- The planning horizon should be 30 years
- Include physical and financial analyses
- Study should be based on actual current conditions of the building’s systems and components
- All systems should be included, for example, the exterior enclosure, electrical, mechanical, fire detection, site works, etc.
To keep your costs down, have available:

- Original drawings
- Past investigation reports
- A summary of past repairs and renewals
- A list of equipment
- Financial statements
- An owner committee to work closely with the consultant during the data collection stage
What are reserve funding models..?

- **Baseline Funding.** The goal of the baseline funding method is to keep the reserve cash balance above zero. While each individual reserve account may not be fully funded, the reserve balance does not drop below zero. This method relies heavily on special levies in order to raise funds to perform the work.

- **Statutory Funding.** This method is based on local statutes. To use it, the owners set aside a specific minimum amount of reserves as required by statutes.
What are the reserve funding models..?

→ **Threshold Funding.** This method is based on the baseline funding concept. The minimum reserve cash balance is set at a pre determined dollar amount.

→ **Full Funding.** The goal of the full funding strategy is to attain and maintain the reserve at or near 100%. This is achieved by placing a sufficient amount into the Reserve Contribution to ensure that no Special Levies/Assessments are needed in the future.
How well funded are we?

- **Good Level.** While the 100% point is ideal, a reserve fund above the 70% level should be considered ‘strong’ because cash flow problems are rare.

- **Fair Level.** If the reserves are 31 to 70% of the total Required Reserve, then the Current Reserve is considered to be in a mid-range level.

- **Poor Level.** At this funding level, special levies are common. This is also commonly known as the Unfunded or Special Levy Model, which is the default model in place with many strata corporations.
What is the bottom line...

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<thead>
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<th>Current Funding</th>
<th>Alternative</th>
<th>Fully Funded</th>
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<tr>
<td>Annual reserve allocation</td>
<td>$24,200</td>
<td>$100,000</td>
<td>$293,000</td>
</tr>
<tr>
<td>Per suite per month</td>
<td>$ 30.10</td>
<td>$ 124.38</td>
<td>$ 364.43</td>
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<tr>
<td>Per square foot</td>
<td>$ 0.20</td>
<td>$ 0.83</td>
<td>$ 2.43</td>
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About this strata corporation
- Townhouse complex, Surrey, BC
- 67 units, 120,667 square feet heated space
- 11 years old
- Spa, fitness room, guest suite, lounge
30-Year Funding Scenarios

**Status Quo:**
7 special assessments
$5,900,000

**Alternative 1:**
3 special assessments
$4,200,000

**Alternative 2:**
1 special assessment
$1,600,000
Liability of Commissioning/Not Commissioning a Study

→ What is the liability of a strata corporation that exempts itself from the requirements and does not obtain a reserve fund study?

→ How will compliance be measured?

→ What is the liability of a strata corporation that does not exempt itself from the requirements and fails to obtain a reserve fund study?
Liability of Commissioning/Not Commissioning a Study

→ Should the owner developer be required to have a reserve fund study performed on a new building?
→ How will new buyers identify the future liabilities if the owner developer is exempt?
→ What impact will a reserve fund study have on buyers & sellers?
→ What information will the strata corporation have to disclose to a buyer?
→ What information will have to be disclosed to: insurance providers, appraisers, mortgage insurers, financial institutions?
Impact on Real Estate Valuation & Disclosure

→ Will a reserve fund study affect our property values?

→ Will the study/no study impact the ability to sell my strata lot?
Questions

How can I be involved?
Website:  www.choa.bc.ca
Select:    Alerts & Updates