

The Reserve Fund Study

Planning and Monitoring Tool
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Background and Overview

The “Act” requires all condominium corporations to maintain a separate fund “the Reserve Fund” and undertake on a regular basis a Reserve Fund Study

Reserve Fund: What is It?

- Section 93(2) requires that a corporation maintain a separate fund to be used solely for the purposes of paying for the existing major repair and replacement of the common elements and assets of the Corporation
- Section 95(1) – The reserve fund can only be used for existing common elements and assets of the corporation

The Reserve Fund Study

- Necessary in order for the Board of Directors to know the amount of money currently in the reserve fund and the amount of contributions collected for the reserve fund are adequate for the expected future costs of major repair and replacement of the common elements and assets
- The study should be considered a planning document that the board and its manager uses in the current and future cash planning of the corporation

Classes of Reserve Fund Studies

- Comprehensive (Class 1)
- Site inspection with cash flow update (Class 2)
- Cash flow update (Class 3)

Who are Permitted to do Reserve Fund Studies

- Accredited Appraisers
- Architects
- Certified Engineering Technologists of Ontario
- Architectural Technologists
- Holders of a CRP designation
- Professional Engineers
- Quantity Surveyors
- Graduates of Ryerson University with a Bachelor of Technology (Architectural Science) Building Science or Architecture option.

What Information does the Corporation need to Provide?

Once you have hired a consultant, he/ she will require information about the condominium corporation. This will include the following:

- As-built drawings and specifications.
- The Declaration and Description.
- The Standard Unit By-law (if one exists)
- Reciprocal cost sharing agreements.
- Previous reserve fund studies.
- The most recent audited financial statements.
- What the current annual contribution to the Reserve Fund is.
- The interest rate on the Corporation's Reserve Fund investments
- Repairs or replacements to the common elements that have already been completed and when. Similarly, scheduled future work needs to be accounted for.
- A summary of problems being encountered by the Corporation that should be reviewed. As an example, water penetration concerns.

What Is the Process?

- One of the most important are the drawings. They will be reviewed prior to visiting the site in order for the consultant to become familiar with the overall design and construction schemes. The declaration and description are also necessary to confirm what exactly are the common elements.
- Site inspection. In order to have an understanding on the current condition of the common elements, visual inspections are undertaken. Problem areas noted above can be reviewed. At the time of the inspection, it is opportune to meet the consultant to review any matters that may be appropriate.
- The report is then prepared. The drawings are used to "take-off" quantities such as roofing, exterior wall cladding, asphalt, hallway finishes etc. that will assist in preparing the replacement/repair cost budgets. It is recommended that a draft report should be submitted in order for the Board and Property Manager to review it prior to it being finalized. The consultant should be available to attend a meeting to review the report.
- Upon receiving direction from the Board of Directors, the Reserve Fund Study is finalized and submitted.

Contents of the Study

- Background Information about the Corporation in general; where it is, its age, a general description of the property as a whole.
- Inspection Report. Based upon the results of the site inspection, the report will provide an itemized overview description of the major common elements. This will include general condition, the need and timing for remedial work or replacement and any other information that the Board should be aware of.
- Information Tables. There is typically a table that summarizes the common elements in terms of current age, life expectancy, remaining service life and current and future cost budgets.
- Expenditure Tables. The data from the Information Tables is summarized to show in a tabular format when the itemized common element repair/replacements are estimated to take place. For each year, these expenditures are summed. The annual projections must be a minimum of 30 years commencing in the year the Study is prepared.
- Cash Flow Tables. Based upon the estimated expenditures, different contribution plans can be provided at the draft submission. Often, one plan includes the contribution level currently being used as a form of comparison to other scenarios. The adopted contribution plan "Will be included in the finalized study.

Financial Analysis

- The estimated cost of major repairs and replacements based upon current costs.
- The same costs adjusted to account for an assumed inflation rate. The inflation rate must be stated in the study. (Construction cost index is preferable)
- The opening balance of the reserve fund.
- The recommended amount of contributions to the reserve fund determined on a cash flow basis that are required to offset adequately the expected cost in the year of the expected major repair or replacement of the common elements and assets.
- An estimate of the interest earned on the reserve fund contributions based upon an assumed interest rate. The study shall state the interest rate (as provided by the corporation). The Act requires that interest generated by the Reserve Fund is reinvested into the Fund.
- The percentage increase in annual contributions to the reserve fund for each year of the 30 year study period.
- The estimated closing balance of the reserve fund for each year.

Contribution Options

- When the Board receives the draft study, it may show that the current level of contributions to the reserve fund is insufficient to address the estimated future expenses. The Corporation has at its disposal essentially two sources of contributions to the reserve fund. One is via unit owners. A portion of each month's common element fee payment goes into the reserve fund. This is the usual method of contribution to the fund. With a Special Assessment, each unit owner is required to pay an extra amount for a set period of time.
- The second source of funding is by way of outside financing (a loan). Banks and private companies are in a position to lend funds to condominium corporations subject to certain conditions. Loans are becoming more appealing especially for condominiums requiring a significant amount of money for more immediate repair or replacement needs.

Contribution Increases

- For the vast majority of condominiums (registered prior to May 5, 2001), the Act permits a period of 15 years from the date of the first study (done after the Act) to achieve an "adequate" reserve fund. Depending upon the current amount in the fund and when during the study period of 30 years the expenditures take place, in most cases where the fund is currently inadequate, simply increasing the contributions to the fund is all that is necessary. Again there are different approaches the Board can consider by way of the draft reserve fund study submission.

Contribution Increases

- A lump sum increase from the current contribution is possible followed by "cost of living increases" in the subsequent years. This in effect is a Special Assessment and generally is not very palatable if it is a large amount.
- A consistent percentage increase over the 15 year catch-up period. In this case for the first 10 years of the cash flow analysis, the annual contributions are increased by a fixed percentage rate (say 15% per year for 15 years) after which a nominal annual increase (perhaps 2%) is applied for the next 20 years.
- Boards may wish to have aggressive contributions at the start of the study and for the next few years, gradually reduced to a cost of living level by Year 15 when positive cash flow over the entire 30 year study period is achieved.
- For condominium corporations registered after May 5, 2001, the Act requires that the entire catch-up take place in the first fiscal year following the fiscal year in which the reserve fund study is completed. This can be very onerous if the budgeted amount (usually determined by the Declarant) is substantially less.

- Reserve Fund Study Updates must be done in the proper sequence and with regularity. This is to ensure that the reserve funds are maintained at proper levels and with appropriate contribution adjustments.
- The Reserve Fund Plan is exactly that – a plan – not something fixed in stone.
- In my opinion a 30 year forecast is too long to project with any reasonable degree of accuracy. Any forecast beyond 4 to 5 years begins to lose its credibility because of construction cost increases alone.
- Investment return rates may be unrealistic in the short term

- While Reserve Fund Studies are required to be updated a minimum of every three years, DO NOT hesitate to have the Study updated more frequently, when a major repair is required ahead of schedule.