

Valuing Diversity Conference 2016

# Impact of Depreciation Reports

# Strata Property Statistics BC

- 28,000+ Strata Corporations
- Estimate 1.2 million strata units
- Estimate 22,000+ qualifying Strata Corporations
- Estimate 960,000 qualifying strata units in BC

# Strata Property on Vancouver Island

- BC Assessment roll data indicates  $\pm 62,000$  strata units (2013)
- If BC wide ratios hold true, 80% of units would be within qualifying (>5 unit) complexes;
- Based on BC wide ratios, this would equate to  $\pm 1,100$  complexes on Vancouver Island
- $\pm 65\%$  of total strata properties are located in the Capital Regional District

# Types of Strata Property

According to CMHC, condominiums in 2011 comprised:

- high-rise apartments (31%) (5 storey +)
- low-rise apartments (36%) (less than 5 storey)
- row houses (23%)
- single-detached houses (4%)
- other dwelling types (6%) (duplexes, single-attached, semi-detached houses, and movable dwellings)
- high rise apartments are limited outside of major metropolitan areas

# BC Strata Property Act

Legislation enacted in December 2011  
(relating to Depreciation Reports)

- Date of December 2013 is now 2.5 years past
- Still many Strata Corporations completing their first report
- Updated Reports - every three years (after initial report)

Who is exempt?

- Less than 5 Strata Lots
- Or with  $\frac{3}{4}$  vote for exemption

# Qualifications

- Strata Property Act silent on who is qualified to prepare the report...
- Provincial legislation specifies certain minimum requirements for Depreciation Reports
- Form and format of reports can vary, depending on background and training of the Reserve Fund Planner (ie. engineer versus appraiser versus architect, etc.)

# Qualified?

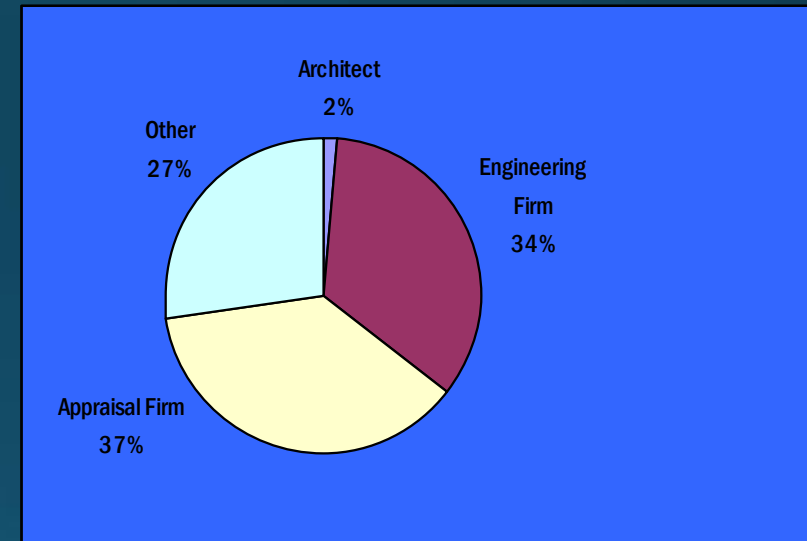
Condominium Home Owners of BC (C.H.O.A.) suggests:

- Member of the Appraisal Institute of Canada (AACI)
- Member of the Real Estate Institute of Canada – with Certified Reserve Planner designation (CRP)
- Quantity Surveyor
- Engineer
- Architect
- Others persons who meet the qualifications and skills required

# Who is Completing Reports?

- VISOA  
(Vancouver Island Strata Owners Association)  
1 architect; 4 engineering firms;  
6 appraisal firms; 2 other (all ±)
- CHOA  
(Condominium Home Owners Association of BC)  
34 engineering firms; 16 appraisal firms;  
14 other (all ±)

*(As advertised in the business directories)*



- REIC Website indicates 55 CRP's in BC. It is unknown how many are active in the field.
- Many, many others...



# Depreciation Report Findings

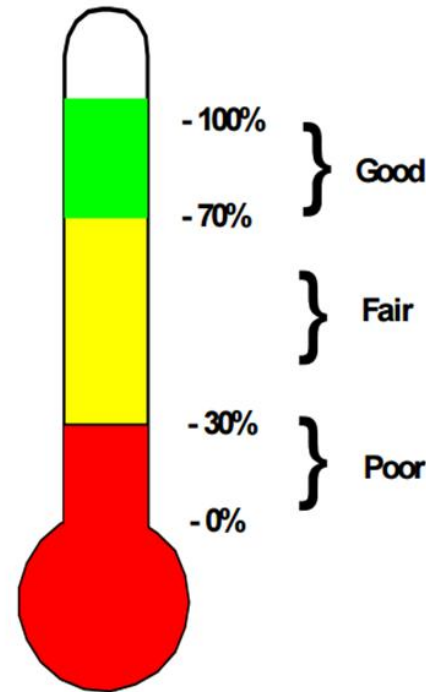
Sample size of  $\pm 100$  reports, located predominantly on Vancouver Island and some in the Interior BC/Kootenay Regions:

- 73% ordered by Strata Management companies
- 27% by self managed strata corporations
- 57% low rise apartments (4 storeys or less)
- 26% townhouse style
- 8% ground oriented patio homes
- 8% commercial or mixed use commercial/residential
- 1% bare land strata

# Comparison to Full Funding

- CRP's utilize a 'benchmark' analysis which compares current funding levels (CRF balances and contribution levels) to a 'fully funded' model.
- "Full funding" describes the objective to have reserves on hand equivalent to the value of the deterioration of the each reserve component. The objective is to have the ongoing asset deterioration offset by the proportional accumulation of cash.
- For example, if a roof is to be replaced in 10 years at \$50,000 the strata would need to be contributing \$5,000 per year to fully fund this component (at 0% interest and 0% inflation). Or some combination of a current reserve balance and contribution. Inflation and interest assumptions do factor into the requirements.

# Full Funding Comparisons



→ **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.

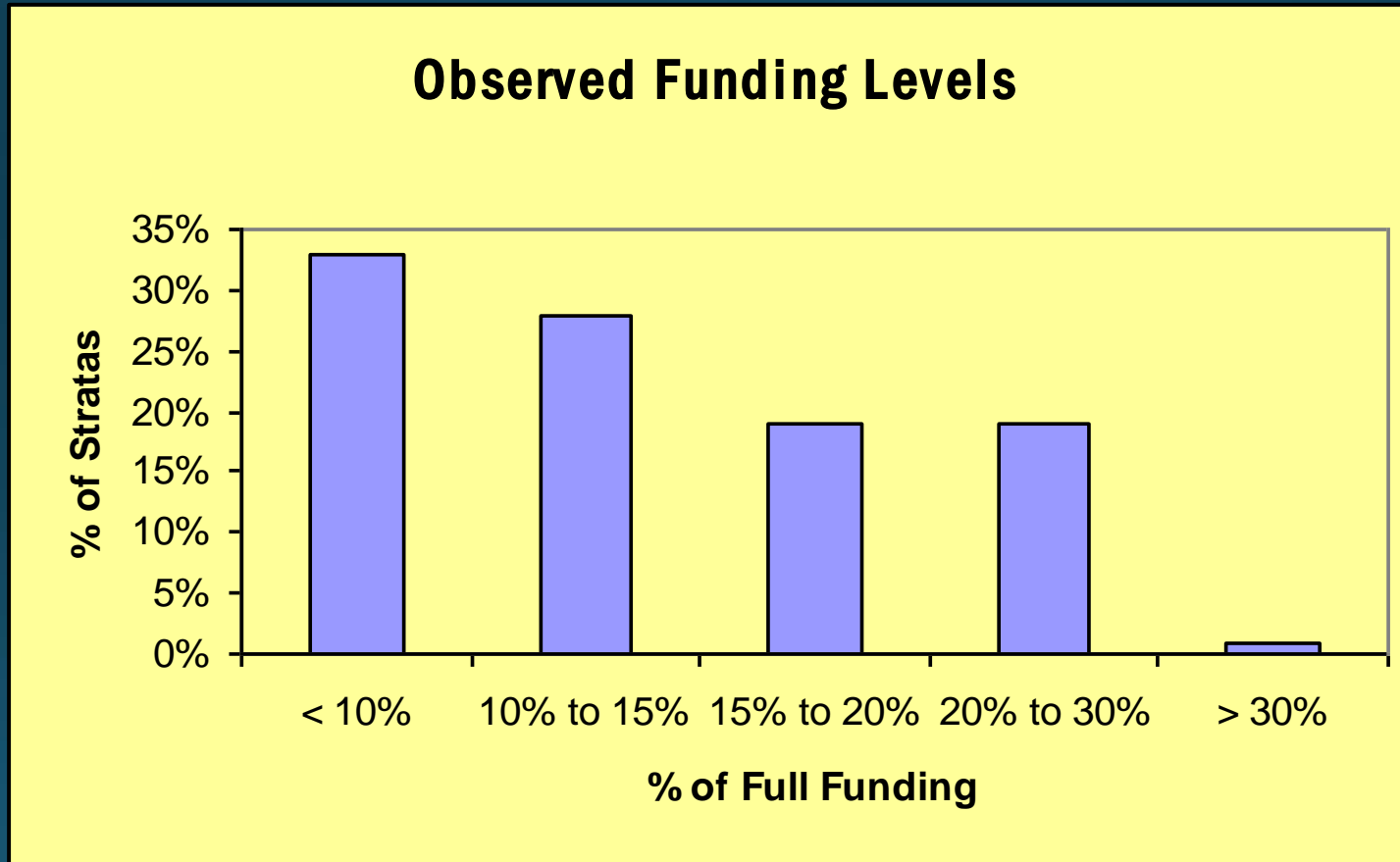
→ **Poor Level.** At this funding level, special levies are common. This is also commonly known as the Unfunded or Special Levy Model, which is the default model in place with many strata corporations.

# 2012 to Date Initial Depreciation Reports

Sample size is  $\pm 100$  completed reports on Vancouver Island and BC Interior/Kootenay regions:

- 33% less than 10% of full funding
  - 28% between 10 and 15% of full funding
  - 19% between 15 and 20% of full funding
  - 19% between 20 and 30% of full funding
  - 1% above 30%
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- 99% would fall into the 'poor' category as defined above and suggests very little forward planning and a more reactionary environment.
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- A lot of strata's utilize a minimum funding ratio (ie. 10% of budget)

# Findings



# Impact of Depreciation Reports

- Strata managers report that the vast majority of complexes under professional management have completed the initial report.
- Self managed stratas continue to have some hold outs who continue to defer, however the % is difficult to estimate.
- A lot of strata corporations have realized they are and have been underfunding their reserve fund.

# Impact of Depreciation Reports

- Consequently, contribution levels have increased in the vast majority of cases;
- Property managers report that funding levels have increased which has resulted in increased strata fees;
- Of the management companies and stratas interviewed, most have utilized an 'adequate funding' type model where the contribution levels have been increased on a gradual or stepped basis over the 30 year term.

# Impact of Depreciation Reports

- Very few stratas have elected to pursue a full funding model;
- Further, the document is being utilized widely by management firms as a budgeting/planning tool.
- Most indicated that the report was a valuable tool for planning and budgeting purposes.



# Three Year Renewals/Updates

- Early adopters (2012-2013) are approaching or at the 3 year renewal as specified within the Act.
- A high percentage of complexes are deferring the update in favour of a longer time frame (5 years);
- Complexes with limited expenditures in the initial 10 year portion of the 30 year plan are reported to be strongest advocates for longer time frames between updates;

# Strata Transactions

- Given the increase in strata developments throughout BC, there is a strong likelihood that at least one (if not more) of a new REALTOR®'s transactions will be in strata.
- In 2013, the probability was calculated at 64%

# Strata Documents

- These documents include:
  - Financial statements
  - Minutes
  - The strata plan
  - Bylaws and rules
  - Form B – Information Certificate
    - If the strata corporation has completed a depreciation report, this will be included with the Form B

# The Real Estate Council of British Columbia

- RECBC's rules require REALTORS® to familiarize themselves with the strata corporation's documents, such as the depreciation report, however they are not to interpret the documents or they may face liability.
- Rather REALTORS® are to advise their clients to seek legal, accounting, or engineering advice because REALTORS® are not insured to provide information that is beyond their scope of practice.
- This leads to some concerns:

# Depreciation Reports – Concern #1

- Customer Service or liability
  - REALTORS® on the street know that they are not to provide specific interpretations of the content in a depreciation report for example.
  - However, frustration ensues, because REALTORS® feel that they may be jeopardizing their client relationships by not being able to provide specific perspectives to their clients; and b) there are a lack of professional resources that REALTORS® can draw upon to get the answers that their clients seek.
  - In Alberta, for example, there is a specific professional group that reads and reviews all depreciation reports for completeness and accuracy. This does not exist in B.C., or if it does, the person may not be licensed to do so.

# Depreciation Reports – Concern #2

- Too much variability
  - As previously mentioned, depreciation reports are prepared by different professionals, in different formats, with different language and can range from 20 – 200 pages.
  - A REALTOR® may not even know where to begin.
  - Impact on pricing. While this has seemed to have dissipated as consumers and REALTORS® gain more comfort with the idea of the reports.

# Report Checklist

1. Is the report current?
  - Look for the date on the front cover or where it is signed by the drafter.
2. Was it drafted by a qualified person?
  - Look for a statement of professional qualifications (engineer, architect, building scientist, appraiser, building inspector, or certified reserve fund planner)
3. Is the Depreciation Report Drafter Insured?
  - According to the *Strata Property Act* the drafter must disclose in the depreciation report whether or not he/she/they have insurance.

# Report Checklist continued...

## 5. Is the inventory complete?

- Beware of depreciation reports that leave out major building components like the building envelope or the roof. When the REALTOR® has viewed the building he/she should make a list of all the major components and cross-check the against the inventory in the depreciation report. Does the inventory match the bylaws?

Bylaws will contain information about what the owner must repair, and what the strata corporation must repair. Read the repair and maintenance bylaws and ensure the inventories match up.

- Some strata corporations are mixed-use (commercial and residential) or mixed-type (apartment and townhouse). Check to see if the bylaws section the building and if so, ensure that this is reflected in the depreciation report.



# Report Checklist Continued

## 6. Are the repair bylaws legal?

- Sometimes bylaws can be manipulated to reduce repair and maintenance obligations. Look for bylaws that have made owners responsible for repairing doors and windows on the exterior of the building or common property crawl spaces and attic spaces.

## 7. Are there 3 financing options?

- There must be 3 to be compliant with the *Strata Property Act*. Check if one of the models represents the current financing model

# Report Checklist Continued...

8. Are there red flags in the financial forecast?
  - Does the depreciation report show major expenditures in the short-term – this could be a red flag for first-time buyers or Seniors on a fixed income for example.

# Depreciation Reports – Concern #3

- Total Cost of Ownership
  - The depreciation report attempts to forecast out what major assets will need attention in the form of a repair or replacement, when, and approximate cost allocation over a 30-year period.
  - Costs will change over time based on inflation and strata corporations may take on and/or continue to repair assets which is why the depreciation report needs to be conducted and written every three years.
  - Total Cost of Ownership goes beyond the purchase price with ongoing payments that may range from minor to severe depending on the condition of each strata corporation and how well it is financially prepared.

# Depreciation Reports – Concern #4

- When reviewing reports watch for missing major elements. For example was the roof assessed? Is there comment regarding the exterior? Is there a Building Envelope Condition Assessment (BECA)
- Costing or estimates: Estimates may not be accurate and the effect can be that it drives away buyers. Roofs and Elevators are common examples. An estimate is given in the report for \$100,000.00 repair and the strata seeks its own estimate which comes in at \$30,000.00. The strata then files an appending document. The Buyer is faced with what is that actual cost going to be?

# What happens if....

- The report is not accepted by anyone? Situations have occurred where strata's will try and hide a report or engage a second company as they are unhappy with the first report.
- As a REALTOR® if you discover that this is the case, advise your buyer to seek independent legal advice.

# Financing and Depreciation Reports

- REALTORS® are experiencing situations where financing is challenging when a Strata is in the midst of its repairs and does not have a certificate of completion.
- Currently about 50% of mortgage lenders are requesting Depreciation reports for their approvals.

# Financing and Depreciation Reports continued.

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- The Lenders not currently seeking Depreciation reports may only do so in the event that an issue is noted on the Property Disclosure Statement or the Form B.
- Lenders are still looking for large-scale issues with properties:
  - -Water Ingress in the envelope
  - -Water ingress in any of the other property membrane (ie: parkade)
  - -Delayed maintenance on Roof/Reroofing issues causing damage to property

# Financing and Depreciation reports continued.

- When looking at non-structural issues, the Lenders will look at Contingency reserve funds/vs. cost of maintenance/repair needed to fix the property. (Items such as Re-piping, Window or deck replacements, boilers or heating system issues in the property). Stratas with large contingency reserve funds will general not cause concern for the lenders.
- Complexes with smaller contingencies will generally raise concerns. Lenders will then look at the purchaser and their ability to possibly afford a possible assessment if one is levied.
- We have seen declines of insurance with files where there is a significant amount of deferred maintenance, low contingency reserve and little to no savings of a borrower outside of their down payment and closing costs.



# Mortgage Insurers

- Insurers are taking a hard look at Depreciation reports.
- While the insurers themselves don't request the report for insurance purposes it tends to the private mortgage insurance companies (Canada Guarantee and Genworth) that generally "flag" buildings if they have been presented with the Deprecation Reports. CG and Genworth have a more "hands on" approach with the underwriting and approval of mortgage insurance. If a file is reviewed by an underwriter and there are issues noted on the Property Disclosure or the Form B, it is likely that the insurer will ask to review the Deprecation report. In some instances, lenders are advising the Insurers of properties with significant issues to ensure that these properties are not freely financed.

# Mortgage Insurers continued.

- Canada Mortgage and Housing is a little more automated thus the review of strata documents by an individual happens less often.
- Insurers are also noting properties in which large scale issues are noted or properties in which maintenance has been slack.
- In these cases, we need additional information and reports on any work done to the building to reverse the Insurers decision that the properties are not insurable.
- We have noticed a growing trend in insurers declining properties due to large scale or deferred maintenance needed.