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Reserve Fund Planning

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Figuring Out An Owner's Ceiling Amount Of Reserve Fund Contributions Is As Basic As Determining Their Net Worth

Are Strata Council officers presently equipped to make sound financial decisions about the Reserve Fund (RF) contributions portion of Strata Fees? After five (5) years of required Depreciation Reports (DRs) in BC, what is the common ground on Reserve Fund Planning and Reporting (RFPR)? Are stakeholders in agreement about the importance of standard procedures and tools to achieve useful results? How are consumers protected under the present regime?

While some skill is needed to understand reserve fund planning tools – and to interpret their results – the government's Strata Property Act (SPA); legal precedents; court rulings; the media; stakeholders, and professional opinions are failing to lead Strata Councils towards standardisation. Owners' hold on their money, their gut feelings, or the little attention they are willing to give to managing common assets are still prevailing over the standard way to measure the position of a reserve fund, and the resulting owners' contributions.

Having attended many Strata Council and Owner meetings as a treasurer, president, trade, contractor, consultant for engineering and appraisal firms, and as a reserve-fund planner – on most of the strata fence's positions – it appears that Owners have diverging opinions on the perspectives that professionals hold. This situation dilutes respect for a common standard to RFPR.

Owners who have experienced war or systemic corruption have a different understanding of trust in the information provided by authorities or professionals. Some Canadians defer to authority because they have no tradition of identifying a government as a source of oppression or conflict. Yet the habit of deference to authority – an officer, a property manager or a professional – is ingrained in most strata corporations. This is not always a good thing, as it keeps Owners complacent, attached to opinions, or in the dark. This doesn't change the fact that a standard is crucial to producing useful information for mitigating the risk of a disruptive ¾ special levy.

When it comes to knowing the fair-share of owners' use of common assets, stakeholders should find comfort in knowing that determining a RF's position – where the RF stands in relation to where it should be – is no different than determining a person's net worth – a financial value at a point-in-time. There are standard methods for measuring both.

While the REIC CRP RFPR functional methodology has been used across Canada as early as in the 1970s, the government has not made it clear that there is but one standard for measuring the position of a RF, and the fiscal-year based ceiling amount of contributions to be drawn from Owners. There are no strata police. The standard for RFPR continues to be maligned, and variations on the standard have made it difficult to compare two strata lots in relation to the liabilities of two developments.

It is presently difficult to rationalize spending thousands on non-compliant DRs. Why not stick with the SPA guideline, forget about DRs, and stash $25,000 in a personal account in case a surprise ¾ special levy comes up? That would not be fair to the corporation, nor to current and future Owners – especially when a tried-and-true methodology for determining RF contributions exists. And it is misguided because it leads lenders to impose higher mortgage rates at renewal time, and because it has Owners content about not paying their fair-share of the true-cost of ownership.

Strata finances are organized around the Operating Fund, RF, and ¾ Special Levy Fund. Sound risk-management requires the fiscal-year management of the first two funds.

When Strata Council officers meet at their Annual Budget Meeting (ABM), they work on producing the Proposed Budget. They compare the actual Operating expenses and RF expenditures to what was approved at the last Annual General Meeting (AGM). Variations are explained, and help set the next Proposed Budget. Then, officers shift attention to upcoming RF renewal projects – that occur every two fiscal-years or more – as these require planning, inspections, tendering, scheduling etc. several fiscal-years before they are undertaken. Reviewing when renewals are to occur helps officers know how much of the remaining restricted monies can be invested – interest income reduces contributions, and when these investments are to mature – up to five fiscal-years in the future.

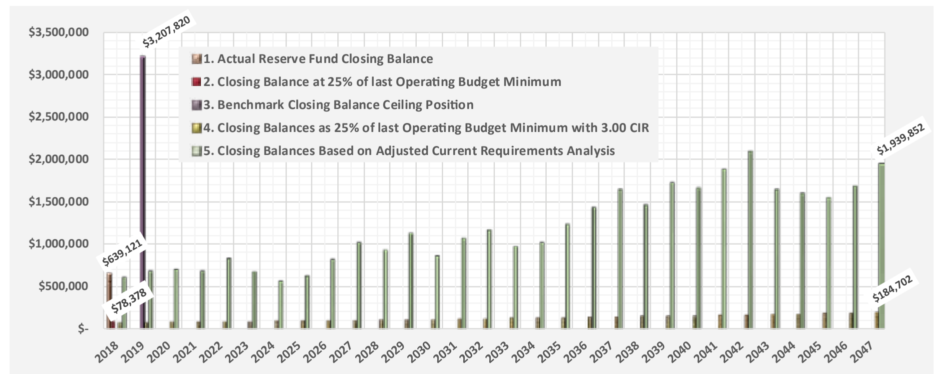
What the Strata Council produces for a simple majority 50 percent vote with its Proposed Budget are the total strata fees divided into two allocations: a portion to the Operating Fund as monthly revenues to meet the unrestricted expenses for the fiscal-year, and a portion allocated to the RF as restricted monthly regular contributions – monies owed to the Strata Corporation for use of its assets one fiscal-year at a time. Well managed and risk-adverse corporations allocate between 15 to 30 percent of their strata fees to the RF to cover Owners' use of aging – depreciating – common assets one fiscal-year at a time. Knowing that insurers and developers unwillingly setup strata corporations to fail with the 5 to 10 percent of the Operating ratio, is relevant as owners are forced to play catch-up. Indeed, this ratio has little to do with the common assets' needs, which are best measured by the RF position at a point-in-time.

The SPA's guideline for reserve fund planning introduced another ratio, based on the Operating Fund financial results, taken from immediate past and current fiscal-years. How useful is this ratio for planning the future needs of a corporation's common assets?

There is a weak relationship between repeated Operating Fund daily, weekly, monthly, yearly bills – an electrical bill – and the development's aging windows or roof. Since the Operating Fund is for re-occurring items needing revenue to offset them, and the RF is for every two fiscal-years or more major repair and replacement expenditures for common assets and fiscal-year RF contributions – it makes little sense to rely on the SPA ratio for sound-management. While it remains as a basic guideline, the SPA has it that DR recommendations override the SPA ratio once acquired. Still, no closing RF balance is to be below the 25 percent threshold, otherwise the equivalent of 10 percent of a current fiscal-year's Operating Budget is to be contributed to the RF, which only complicates planning. The purpose of requiring DRs was to move us away from minimums, last minute fixes, ad hoc decision-making, and surprise levies. Conducting reserve fund planning with this approach also makes it difficult to compare finances across councils in time and strata corporations in space.

The only planning we can reasonably do with operating budgets is to project the SPA guideline ratio's result: a minimum Closing Reserve Fund balance, adjusted in future fiscal-years with the Consumer Price Index (CPI) – or more reasonably with the Construction Inflation Rate (CIR) – since common asset RF renewal projects are affected by construction material and labour inflation rather than the price of tomatoes.

The graph to the right illustrates the results of this analysis for an existing strata corporation, along with the REIC CRP functional methodology's resulting recommended closing balances, based on the standard analysis of adjusted Current Requirements. This corporation has a RF with restricted monies above the SPA ratio – but it is still not at the ceiling amount calculated by the standard RFPR methodology. In some provinces, the officers are to fund to the ceiling in the next fiscal-year with a one-time special contribution. Why are the recommendations below the ceiling? If the officers increase their interest income on the monies in the RF, the recommended closing balances will increase significantly.



Planning with the SPA 25 percent of last fiscal-year metric is misguided. The closing balance would never reach the existing closing balance. This approach would continue to lead to ¾ special levies; not motivate Owners to pay their fair-share, and end up costing more, simply because renewal projects would be surprise levy rush-jobs.

Knowing the RF's position based on the depreciation of the aging assets is crucial. It is calculated based on the effective age of common asset major repairs and replacement listed in the active component inventory, as determined by a visual review of their functional condition. The benchmark RF position gives us a sense of how well operating maintenance impacts the major repairs and replacement of the common assets at a point in time, and what is the ceiling amount of monies needed in the RF – much less that then the current costs for the components, or the appraised-value to re-build the development, neither of which measure the depreciation of aging assets. The RFPR focus is on the performance of the assets, not on the prescribed scheduled expenditures of a portion of the component inventory over a projection.

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Certainly, knowing what the projected adjusted fiscal-year-end Closing Balances in relation to the adjusted Current Requirements will be – based on the RF's position – is relevant for planning the future, but focusing only on the expenditures or the closing balances leads us on a roller coaster ride. Knowing what monies are needed for scheduled expenditures is one thing, but setting stable RF contributions considering this volatility, is what astute Owners care about. Knowing that if RF contributions are set to increase at 5 percent each fiscal-year – after a bump in contributions towards the ceiling amount for a few fiscal-years, remembering that the RF allocation is but a portion of total Strata Fees – then the common asset needs of the Strata Corporation are taken care of, should make sense to all stakeholders.

While net worth is a private matter, the RF position is public knowledge. Regarding consumer protection, government and professional RFPR oversight would be beneficial to all stakeholders, but complying to one standard for RFPR over the life of a development – one that is valid across corporations – is key. Just as with the personal net worth metric, the RFPR standard stands the test-of-time and protects against peoples' agendas or professionals' predilections. We should all ask that RFPR be conducted with the same standard, the same procedures, and the same tools. By using the REIC CRP functional methodology for reserve fund planning and reporting we ensure the sound risk-management of personal and shared finances. ■

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He believes that best-practice reserve fund planning can elevate all stakeholders' standards, improve strata living, and lead to better personal and condo/strata financial decision-making.

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