



Demystifying reserve fund studies

Even before 2001, when the current Condominium Act started to require reserve fund studies at least once every three years, the industry was grappling with how to make the best use of this financial planning tool. In broad strokes, a reserve fund study is prepared to identify reasonably foreseeable repairs or replacement of the physical assets of the corporation and create a funding plan that can accommodate the associated expenditures.

BY BRUCE DAVIDSON

This can be a sensitive topic for all parties involved in the condominium industry, be they property managers, unit owners or board members. This article will outline some common problems and suggest possible solutions.

Understanding objectives

Perhaps the biggest misconception in the condominium industry is that a reserve fund study is a fixed schedule, rather than a flexible planning tool. There is typically room to adjust both the building element condition and maintenance (expenditures) and financial (contributions) sides of the equation. Very simply, contributions to the reserve need to be "adequate" to accommodate "reasonably" anticipated expenditures as priorities and circumstances evolve.

To be clear, the make-up and condition of the building dictates the reserve expenditures, not the reserve fund plan. It is the reserve fund plan's job to reasonably anticipate the expenditures before they occur. It is relatively normal for components to require replacement earlier than expected. It is also relatively normal for components to last longer than predicted. That's why it's important to adjust a corporation's reserve fund plan as new information becomes available.

The physical condition assessment portion of the reserve fund study update must be completed a minimum of once every six years, with a financial check-up being completed in alternating three-year intervals. If there are significant changes in priorities or work completed in the interim, however, it may be prudent to reassess the suitability of the reserve fund plan ahead of the three-year mark.

Maintaining flexibility

It's rare that a corporation would prefer to conduct their fee collection for reserve fund expenses through special assessments. (Simply planning for special assessments would not be in keeping with the Condominium Act anyway). Contribution increases are difficult for boards to effect at times, and engineers are somewhat sympathetic to that, although their shared responsibility is ultimately to serve the best interests of a condominium corporation.

Arbitrarily deferring work to meet financial objectives, however, may lead to less than satisfactory results, despite the immediate short-term financial relief passed on to unit

owners (sometimes at the expense of future owners). The result may be necessarily higher contributions for a compensating period of time until the work is completed, which may be a harder pill to swallow than simply increasing contributions sooner.

When a particular item fails sooner than expected, it can often leave a corporation facing a decision between significantly depleting its reserve or imposing a special assessment. In these cases, the

corporation may have some wiggle room to delay somewhat discretionary expenses within the plan to ease short-term financial requirements.

'Somewhat discretionary' refers to aesthetic concerns, rather than the technical concerns or inevitabilities. There's no sense in re-doing the wallpaper if the penthouse units are flooded every time it rains due to poor roofing and there aren't enough funds in the reserve at that time to do both.



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Just as building components can last longer or shorter than anticipated depending on specific application, environmental considerations, etc., their costs are also subject to change. Changes in technology, raw material prices and labour shortages are all factors that could potentially affect the reserve. These factors should be accounted for in updates, which essentially reset a plan, but serve to underline how flexibility is important to these plans.

Balancing physical and financial assets

It's important to strike a balance between the physical and financial aspects of the corporation: On one side of the coin, no one wants their physical capital assets to deteriorate. On the other side of the coin, no one wants to needlessly part with their liquid assets, particularly if they're sitting in a mysterious fund that appears to be doing nothing other than collecting relatively nominal interest.

A condominium board must therefore take care to communicate the goals of the reserve fund to unit owners, to keep them up to speed as to why these monies have been set aside. The reserve fund study process should also be interactive, incorporating input from all parties, when it is safe and responsible to do so.

All reserve fund studies are a time-versus-funding exercise; however, bear in mind that each of their numbers is associated with a potentially disruptive project. It may not make sense to combine projects in the same year as it is both strenuous on a single year's cash flow, as well as disruptive to the owners who have to endure multiple projects in the same year.

It may be possible to defer work on a practical basis, depending on the corporation's maintenance strategy. Phasing in work across multiple blocks or sections may effectively string out the impact financially, but would also spread any associated nuisances to the owners over several years.

These considerations often have a significant impact on reserve planning, and vary depending on the desires of each corporation.

Naturally, with all of the items touched on above there remains the statutory obligation to stay within the limits of the law while keeping the building safe. The current Act leaves much gray area as to what "reasonable" and "adequate" provisions mean with respect to funding. (The proposed Condominium Act reforms, which are now before the legislature, attempt to clarify these terms, amongst countless other matters.)

Deferring significant structural work, for example, comes with significant risks, both with respect to life safety and escalating repair costs. Engineers and other reserve fund study providers need to work within these limits in order to provide an effective final study that the condominium board can then adopt as its plan. □

Bruce Davidson is an engineer with Brown & Beattie Ltd. and an engineer in training with the Professional Engineers Ontario (PEO). He works closely alongside registered professional engineers in preparing many of the reserve fund studies produced out of B&B's Richmond Hill office.