



Brian Antman
CPA, CA
Adams & Miles LLP, Chartered
Professional Accountants

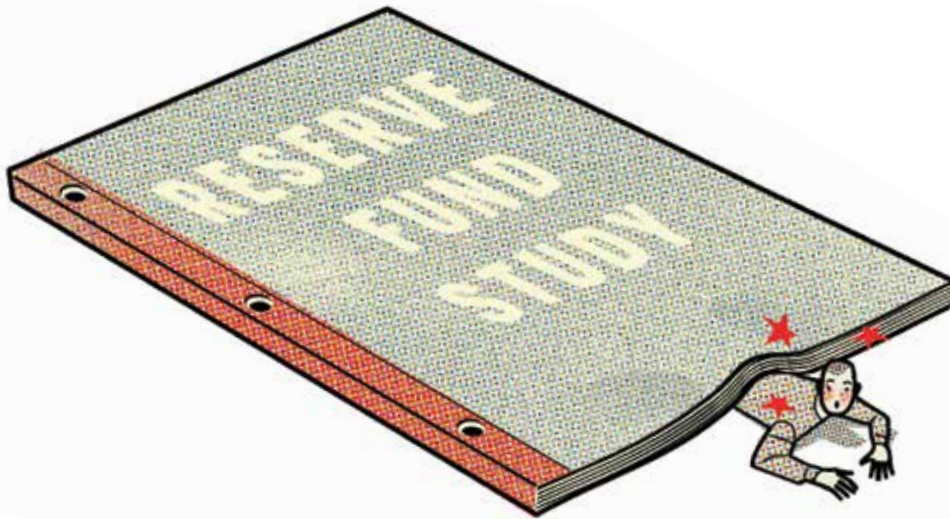


John Warren
FCPA, CA
Adams & Miles LLP, Chartered
Professional Accountants

Condominium Finances

Reserve Fund Studies in Plain Language

Understanding the Incomprehensible – How Reserve Fund Studies are Prepared and What They Mean



Questions about Reserve Fund Studies come up regularly from Owners and Directors who are looking for an explanation, in plain language, of how Reserve Fund Studies are prepared and what they mean. As a reserve fund study is typically a 2 or 3 centimeter thick document (an inch or so for us oldsters) full of detailed building information, it is incomprehensible to almost all who attempt to read them. The devil is in the details, but hopefully we can explain the most

significant details without resorting to much technical language. To paraphrase the Condominium Act:

A Reserve Fund is:

A fund that collects monies from owners to pay for future major repair and replacement of the common elements and assets (common elements for simplicity).

A Reserve Fund Study is:

A study that calculates for each of the next

30 years, estimated interest on funds accumulated, future repair and replacement costs and amounts to collect from owners that can reasonably be expected to pay those costs. Studies are performed every 3 years with a site inspection every 6 years.

Reserve Fund Studies

Reserve fund studies are prepared by qualified professionals such as engineers and contain the following:

1. List of all components of the common elements of the corporation costing \$500 or more, including, in some cases, an amount in a contingency line for unknown expenditures
2. Determination of the nature and extent of major repair or replacement that will be required for each common element or class of common elements
3. When, in the next 30 years, major repairs or replacements are likely to take place
4. Current costs to make those major repairs or replacements,
5. Future costs to make those major repairs or replacements
6. Interest rate to calculate interest earned on accumulated funds
7. Inflation rate to calculate future major

ILLUSTRATION BY JASON SCHNEIDER

repair and replacement costs

8. Contributions to the reserve fund each year that can be reasonably expected to provide sufficient funds to pay for expected major repair and replacement costs.

1. The list of common elements includes everything but the units. Typically, unit owners are responsible for everything inside their units to the back

side of the drywall and from the floor slab underneath to the ceiling slab overhead, including toilets, sinks and pipes inside the unit but not including windows and doors. The condominium is responsible for everything else, including wall, floor and ceiling slabs, electrical, mechanical and plumbing equipment and pipes, roof membranes, entrances and hallways, garage, amenities, grounds, drive-

ways, fences and anything else not within the units.

2. Many common elements will require complete replacement at the end of their useful lives, such as carpets and wallpaper, roof membranes, windows, doors, plumbing, heating and air conditioning equipment. Complete replacement, when necessary, can sometimes be done in stages to spread costs over more than one year. Some common elements will require only partial replacement or repair such as building walls, garage floors, landscaping and driveways. Reserve Fund Studies generally also include a contingency line to allow for items such as regulatory changes and additional costs that may occur as the visual inspection may not enable the inspector to determine all work that may be required.

3. The year that major repair or replacement may take place is estimated based on the physical condition of the common elements at the date of the latest reserve fund study that included a site inspection and the life expectancy of the item or class of items.

4. Current costs are estimated based on costs for comparable work accumulated by the Reserve Fund Study provider.

5. Future costs are estimated based on current costs, plus an inflation factor to arrive at the costs expected in the year of major repair or replacement.

6. The interest rate used to calculate investment income is estimated based on interest rate averages over periods chosen by the Reserve Fund Study provider.

7. The inflation rate used to calculate future costs is estimated based on construction cost inflation rates over periods chosen by the Reserve fund Study provider.

8. Future annual contributions are calculated based on the data accumulated in items 1 through 7 above, such that the balance in the reserve fund does not go negative (overdrawn) at any time in the 30 year period. In some cases a minimum year-end balance

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may be maintained to provide a cushion for unknown costs. Typically these calculations include above inflation contribution increases only in the first 3 years of the study period with inflationary increases in the remaining 27 years. Future contributions are calculated like this so that the next reserve fund study does not burden future owners with large contribution increases from the previous study.

Notice of Future Funding of the Reserve Fund

The most important information in the reserve fund study is summarized in a *Notice of Future Funding of the Reserve Fund*. This form is distributed to owners each time a new reserve fund study is approved and this one page is all that most people need to understand. While the Notice is a page full of numbers, be not alarmed, it is not complicated; it is just a schedule that sets out, for each of the 30 years of the study, the following:

- Opening balance in the reserve fund
- Add recommended reserve contribu-

Most important to owners is the column that sets out the percentage increase in reserve contributions because this influences how much total common element assessments (CEA) will increase in the coming years

- tions for the year
- Calculation of the percentage increase in contributions over the preceding year
- Add other reserve contributions, if any (such as special assessments)
- Add estimated interest earned
- Deduct estimated inflation adjusted expenditures
- Equals the closing balance in the reserve fund

Most important to owners is the column that sets out the percentage increase in reserve contributions because this influences how much total common element assessments (CEA) will increase in the coming years. As an example, if current

year CEA is \$1,000,000 and the reserve contribution is \$200,000 or 20% of that amount, a reserve contribution increase of 10% in the next year increases the reserve contribution to \$220,000 and, all other costs remaining the same, increases total CEA to 1,020,000, for a 2% increase. As an aside, all other costs typically do not stay the same, tending to increase over time so next year's total CEA may well increase by more than 2%.

Reserve fund studies are not a perfect solution because long range forecasting can never deliver perfection. They are, however, a good solution and we should not let the pursuit of future perfection trump the present good. **CV**

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DSF

2300 Yonge Street, Suite 2900
Box 2384 Toronto Ontario
Canada M4P 1E4

T 416-489-5677
F 416-489-7794
w condolaw.to

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