Can Condos Deal with the Coming Reserve Fund Shock?

Construction price inflation has been significantly higher than consumer inflation over the last three years. Reserve fund study updates completed this year and in 2024-2025 will have to reflect this significant increase in costs even for those projects that are in the distant future.


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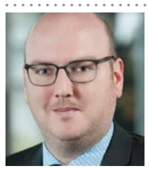
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The resulting increases in contributions will be difficult for boards to implement and unit owners to accommodate, especially given other financial pressures related to consumer price inflation and increasing mortgage rates. Condominiums already behind on their reserve funding will find that this compounds their problems.

Every condo is going to face a significant contribution increase, usually in the range of 30% to 50%, at their next update, and the reality is that the new fees may not be affordable for all unit owners. Those condos that are currently well-funded will fare better than their under-funded peers. Those with substantial projects that cannot be deferred in the near term may face even more significant increases and special assessments.

As reserve fund planners who work throughout the province, we are very concerned with the distressing impact of these cost increases on our clients. Successful condos will face the new reality head-on, but this will not be easy.

According to Statistics Canada, Construction Price Index for new residential construction has raced ahead of the consumer price index per Table 1. This index is not a perfect match to the type of work planned in a reserve fund study, but it is more representative than Consumer Price Index.

Reserve fund study providers typically maintain their own database, including the cost to waterproof and repair parking garages, replace windows, replace HVAC equipment, etc. These databases get updated using various sources, including recently tendered work, budget confirmation with contractors and/or suppliers and project costs at other condominiums.

We are finding that the cost of window replacement, often the most expensive project in a reserve fund study, has increased by about 10-15%+ annually over the past three years. The price of other construction materials such as wood, concrete repairs, roofing, sealants, coatings, and paving has surged by 50-100%, though it appears that the prices have stopped racing ahead in some areas, and a few have even fallen from their peak. HVAC equipment replacement cost has escalated significantly; however, many clients are deferring the work due to long delivery timelines, reducing the amount of data available to know where pricing is going. Contractors routinely seek extras or deposits related to supplier cost increases and material availability. Labour costs are also up, but not as much as material costs.

A combination of factors drives up pricing, such as labour shortages due to the retirement of baby-boomer workers, global factors like the Ukraine war, climatic disasters that impact international material suppliers, and political tensions. And more recently, the mandate by the provincial government to construct 1.5 million new residential homes in the next decade. All these factors are influencing contractors to build risk factors into their bids.

There are some actions a corporation can take to minimize reserve fund spending:

- Complete all available energy-saving projects, both capital and operating. The resultant savings can go towards your reserve contribution.
- Complete proactive maintenance for all building components. Fix leaks promptly to avoid more widespread deterioration. Seal cracks in the pavement to reduce damage to the supporting fill, possibly allowing for the deferral of pavement replacement by many years. Don't cut corners on maintenance, especially not essential programs like HVAC equipment servicing, chemical treatment of your heating loop and cooling tower, or regularly washing your parking garage membrane.
- Collaborate with your consultant to defer what you can if it helps keep your contribution down, but don't delay things you shouldn't. For example, you might defer a major garage renewal by completing a minor repair program in the near term; but don't just postpone the major renewal and ignore the garage because this can result in accelerated structural deterioration. Similarly, you might be able to defer window replacement by retrofitting the windows; don't ignore the windows, leaving owners with drafty and leaky windows that they can't open.
- Be careful about doing unnecessary work. For example, when changing your hot water piping, you might also be tempted to replace the cold-water piping while the walls are open. While bundling projects together can sometimes save costs in the overall life of the building, money might be better spent

Table 1: Comparison of the Consumer Price Index and the Construction Price Index

Year	Consumer Price Index Ontario	Construction Price Index Toronto	Construction Price Index Ottawa
2020	0.7%	7.6%	9.9%
2021	5.2%	25.7%	24.5%
2022	6%	21.9%	11.4%

investigating the condition of the cold pipes. It might be that their complete replacement could be deferred until the next time the hot water pipes need to be replaced.

- Don't assume that the lowest-cost engineering proposal will result in the lowest-cost overall project. Designing a simple but expensive project will always take less effort than engineering a more cost-effective but detailed, smaller project. For example, it is often easier to design for the replacement of a component than design for repairs – but the cost to repair is much less than the cost to replace. You may have saved a few dollars upfront on your consulting costs, but you might overspend on the construction work as a result.

While the board can elect to phase in a required increase, we support the Professional Engineers Ontario Guideline recommendation that this phasing be restricted to three years. This allows the reserve fund to catch up with market changes before completing the subsequent study. More extended phase-in periods defer excessive contributions onto future owners, and this has been shown to result in financial failure and/or serious physical decline over time.

We expect the significant increases in common expenses to create unrest amongst the owners, especially given that many owners are also renewing their mortgages at much higher interest rates. Some may be forced to sell. Requisitions to remove boards will occur.

Boards must be proactive to help the owners understand what is happening and warn owners that this industry-wide shift is coming. Explain that the issue is not isolated to your building. You might consider having your reserve fund study provider present at a town hall session so they can answer the unit owners' questions directly.

Once a board has received a study showing the significant increase, this information should be provided on status certificates. In the case of a large increase, a corporation might be wise to consult with its legal counsel about whether it is appropriate to wait for the study to be finalized before modifying the notice.

Boards ask if we expect prices to fall back to levels seen before the pandemic. It is essential to understand that this is a question of significant deflation, not just a reduced inflation rate. Price deflation is possible for certain items where severe supply-chain constraints have driven demand far ahead of supply but should not be expected for most prices that flow into a reserve fund study.

Governments are working hard to reduce inflation. Their primary focus is on consumer spending, but the same initiatives should help reduce the rate of inflation for construction projects in the future. Fourth-quarter inflation in 2022 has already slowed for the Ottawa region. Toronto is showing no signs of slowing and is at greater risk, given the pressure to build new homes. We will all have to wait and watch to know how long this high inflation will continue – but we don't have to wait to plan accordingly. ■

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