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Associated Reserve Planners of Canada

## 2015 Marks the End of the “Under-Funded” Strata

### *Percent Funded Rating of Reserve Balance Can Be Misleading and is Inappropriate in the Capital Budgeting Process*

It has now been four years since B.C.’s strata regulations changed requiring strata properties to undertake a Reserve Fund Study or Depreciation Report. Many strata properties have, within the provisions of the act, deferred this exercise for various reasons. Perhaps some fear being found to be under-funded and in need of large fee increases. This is a very real concern as unfortunately some reserve planners insist on rating the reserve fund balance using their own theoretical funding model. The “Benchmark Deficiency Analysis”, “Percent Funded”, or any other “Fully Funded” model, is not required as part of the analysis and is not provisioned for under the Act.

The reserve planner’s role is to simply assist council by providing estimates with respect to future costs and timing of repairs. The planner should only provide cash flow options as specified by the Act and prepare the report utilizing the funding plan adopted by the strata. The reserve planner is not a financial planner and imposing theoretical funding models not mentioned in the Act is inappropriate. Strata maintenance fees are effectively another level of taxation and should be kept to a minimum, remain stable, keep pace with inflation, and be sufficient to meet all planned future expenditures.

Many strata corporations in BC have implemented pro-active reserve fund management plans yet still face the risk of having the Depreciation Report state that the reserve is “under-funded” or “deficient”. This practice, developed by a group of “qualified persons”, is not provisioned for by the Act in BC and may be found to diminish property values without cause. The methodology has not been standardized and is not widely accepted or understood in the real estate industry or among strata owners and purchasers. The percent funded rating should not be used to compare one strata to another.

Strata owners and purchasers should be able to easily determine the future cost of ownership by considering the strata fees and planned special assessments as indicated clearly in the depreciation report. The planner should provide a Notice of Future Funding within the Executive Summary of the report. A potential purchaser can then compare one unit's future cost to another.

Council members and strata managers should be aware of these issues and instruct the reserve planner to avoid the use of terms such as "percent funded" and "fully funded". Many people will misinterpret the meaning of fully funded as it is not defined or required by the act. The planner should provide cash flow funding alternatives to council in the planning stage to assist council in adopting a funding plan. The plan for future funding is implemented into the operating budget each year which is presented to owners for approval at the AGM.

Each year council should review the depreciation report including the expenditure schedule and cash flow table. The projected balance of the reserve fund should be compared to the actual balance. Any discrepancy should be disclosed in terms of dollars rather than percentages. Variances will occur when timing or cost of repair vary from the projection. Council should also review planned expenditures for upcoming years to ensure maintenance and repairs are completed in a timely manner.

The theory behind calculating the ideal or fully funded reserve balance has its merits however it also has its shortcomings. The percent funded rating will vary from year to year and the calculation requires assumptions not consistent with the real world. When funds are taken from the reserve and put into the building the rating will drop. Setting a goal of becoming 100% funded is like a dog chasing its tail in that it is a moving target and provides less accuracy and accountability.

Tony Gioventu of the Condominium Home Owners Association (CHOA) identified the issue in a Condo Smarts article in late 2014. He stated, *"The term 'underfunded' is not a legislative requirement and does not apply to strata corporations in B.C. There is no minimum funding requirement and strata corporations may choose to either contribute to the contingency, approve special levies or some model that includes both options. This does not imply that a strata corporation is appropriately funded in any capacity. That decision is left to each strata corporation to consider"*.

Pre-collection of funds by the strata/condo corporation must be within its lawful authority, kept to a minimum, and diligently accounted for. Just as care must be taken not to under-fund the reserve account, equal care must be taken to not over-fund the reserve without the consent and clear understanding of the affected parties. The objective of the Reserve Study or Depreciation Report is to provide *clarity* to the owners as to the *future cost of ownership*. If you think over-funding is the least of the corporation's concerns, consider the recent Alberta Court judgement:

*"It would be an inappropriate stretch to conclude that among the condominium's powers is an ancillary authority permitting the pre-extraction of funds that are not needed immediately for the operation of the condominium. Were it so, individual owners would face potential uncontrolled and unregulated demands to prepay all types of futuristic expectations irrespective of whether or not the eventuality ever came to pass. This is why the elaborate objective "reserve fund" with its parallel structure of checks and balances was devised and implemented when the Legislature amended the (Act)."*

Special levies require approval by the ownership and the need for funds cannot be expressed as a goal to maintain a percent funded level unless this is clearly understood by the affected parties. A special levy must be for specific expenditures and if funds are available the “need” will be questioned.

The BC legislation requires the report be completed by a “qualified person” however, leaves determination of that up to the consumer. The Act also provides for Depreciation Report to include “other information or analysis that the strata corporation or the person providing the depreciation report considers appropriate”.

Ultimately it is the responsibility of council/directors to ensure the person preparing the report is “qualified” and the report meets *all applicable Standards, Regulations and Acts*. There are no Reserve Planning Police and Associated Reserve Planners of Canada is the only national group of reserve planners in Canada to date. ARPC has adopted the ICBI Generally Accepted Reserve Study Standards.

Financial reports, whether provided by a professional, or non-professional, accountant requires that “evidence is sufficient and appropriate to provide a basis for the practitioner’s opinion”. The practitioner’s conclusion, “when appropriate, the conclusion shall inform the intended users of the context in which the practitioner’s conclusion is to be read”. In an audit engagement, the conclusion shall be expressed in a positive form”. The Benchmark Deficiency Analysis and a rating of “underfunded”, does not meet this criteria.

In 2015 there has been some progress made in standardizing this unregulated industry as highlighted below:

- The passing of Ontario’s Bill 106 – Protecting Condominium Owners Act which updated the Condominium Act in that province. Associated Reserve Planners of Canada provided submissions to the Standing Committee on Finance and Economic Affairs.
- ARPC president, Brian Hill, was appointed to the Standards Committee of the International Capital Budgeting Institute (ICBI) which, in March 2015, published the ICBI Generally Accepted Reserve Study Principles & Standards.
- Consumer advocate group, Associated Reserve Planners of Canada (ARPC), adopts ICBI Generally Accepted Reserve Study Principle 3-5.2 *“The component method should never be used for calculating reserve study funding for budgetary purposes, as it requires assumptions that can be used to manipulate the funding plan, whether purposely or inadvertently”*.
- ARPC announces free education modules to be released in early 2016.
- ARPC announces Do-It-Yourself DIY Reserve Management Planning and Reporting Program.
- ARPC appoints Bill Chaffee, CPA, Gary Porter, CPA, RS, PRA and Jacklyn Jolicoleur, retired CPA, to the Advisory Counsel.
- ARPC provided submissions to the Real Estate Institute of Canada (REIC) which was part of the impetus to form a Steering Committee that is charged with ensuring the quality of the CRP (Certified Reserve Planner) education.
- The Appraisal Institute of Canada (AIC) is reviewing its standards (CUSPAP) as they apply to reserve planning.
- ARPC releasing new report templates to ensure its members’ reports are compliant with all applicable Acts, Regulations and Standards including the Financial Reporting & Assurance Standards Canada.

- ARPC endorses RFA Pro Reserve Fund Analysis software as ICBI Software Standard compliant. This is not a spreadsheet but rather a user friendly software platform independently audited by a national accounting firm.
- ICBI has developed Software Certification and protocol to determine if software meets the ICBI standards. Any reserve study software vendor may apply to have their software tested. To date the REIC Benchmark Deficiency Analysis has not been tested.
- Auditing and Assurance Standards Board (AASB) publishes exposure draft on Proposed Canadian Standard on Assurance Engagements.

Brian A. Hill - January 11, 2016

Brian Hill is President of DreamHomeGroup.ca providing Depreciation Reports and Appraisals throughout B.C. Brian is also President of Associated Reserve Planners of Canada Inc. and has been appointed to the Standards Committee of the International Capital Budgeting Institute. <http://www.dreamhomegroup.ca/>

Associated Reserve Planners of Canada (ARPC) was founded out of a need for conformity and clarity in the reserve planning industry currently lacking in Canada. The ICBI Standards have been instrumental in authenticating Reserve Planning as a legitimate industry in the USA, Canada, and other countries. ARPC members include appraisers, home inspectors, engineers and accountants from across Canada.

If you can answer “yes” to any of the following questions, contact ARPC Toll free 1-866-313-4455 or email [info@arpc.ca](mailto:info@arpc.ca) or visit <http://www.arpc.ca/>

- I have concerns regarding the compliance of the report provided to me.
- I am a reserve planner interested in joining ARPC.
- I would like to find a reserve planner.
- I would like to demo and possibly purchase the RFA Pro software.
- I would like to prepare my strata/condo corporation’s own Reserve Study/Depreciation Report.
- I would like to receive training in the reserve planning field.

**International Capital Budgeting Institute** <http://www.capitalbudgeting.org/index.php>

**Financial Reporting & Assurance Standards Canada** <http://www.frascanada.ca/>