



Contingency Reserve Fund Studies and Capital Planning

British Columbia Building Envelope Council
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Presented by:
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We hope you found our presentation interesting and beneficial.
Attached is a PDF of the presentation.

If you have any questions, please call us at (604) 924-5575 or
visit us at www.halsall.com.

Sincerely,
Halsall Associates Limited
Kevin Grasty, P.Eng.



Million Dollar Question



People Manage Assets Worth 10's to 100's of Millions of Dollars. In the Commercial World, Capital Planning is Common Place.

So why is it that in the Strata Residential World, Capital Planning is Largely Ignored?

Three Big Issues

- Money
- Understanding What's Happening and When
- Lack of Professional Advice



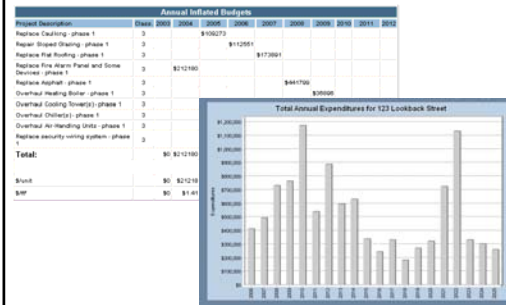
Presentation Outline

- The What and the Why of Capital Planning
- What is a Contingency Reserve Fund Study
- Contrasting Methods of Capital Planning
- What Qualifications are Needed
- The Structure of a Contingency Reserve Fund Study
- Funding Plans: What is Fair, What are your Options
- Updating the Plan

What is a Capital Plan?

- Road map to a facility's long-term needs
 - What? Why? When? Which first? What cost?
- More than engineering, must align with the business needs
- Most effective when supported by sound processes and systems
- Start with the end in mind

What is a Capital Plan?



Why do a Capital Plan?

Everybody has a slightly different need...

- Short-term vs long-term ownership
- Public vs private ownership

When it comes to Strata's, benefits include...

- Can shift from 'putting out fires' to proactive management and planning
- Connect financial stakeholders to the facility condition

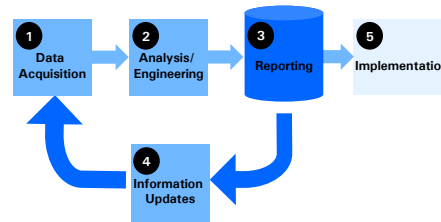
Why do I need a Capital Plan?

Many owners are already doing it...

- Pension funds
- Management companies
- Public Works
- Universities

So why not Strata's....

Capital Planning Process



Capital Planning for Strata's Contingency Reserve Fund Studies (CRFS)

What is a CRF (in the Strata World)?

Strata Property Act: Section 92

"To meet its expenses the strata corporation must establish, and the owners must contribute, by means of strata fees, to

- (a) an OPERATING FUND for common expenses that usually occur either once a year or more often than once a year, and
- (b) a CONTINGENCY RESERVE FUND for common expenses that usually occur less often than once a year or that do not usually occur."

Annual Contribution to CRF

Strata Property Act S.B.C. 1998

Strata Property Act: Section 94

"The strata corporation **may prepare a depreciation report** to assist it in determining the appropriate amount for the annual contribution to the contingency reserve fund."

A Depreciation Report is a form of capital planning. At Halsall we consider it the low tech version of a Contingency Reserve Fund Study (CRFS).

Comparing Legislation

In BC: A Depreciation Report may be prepared

In Alberta: A Reserve Fund Study must be prepared

In Ontario: A Reserve Fund Study must be prepared

In Nova Scotia: A Reserve Fund Study must be prepared

Other Provinces: Legislation is in the works.

Even our neighbours in the USA:


In Washington State: A Reserve Fund Study must be prepared

Annual Contribution to CRF

Strata Property Act S.B.C. 1998

If balance in reserve fund is:


- less than 25% of annual operating budget → Contribution at least 10% of operating budget
- greater than 25% but less than 100% of annual operating budget → Contribution may be any amount
- greater than 100% of annual operating budget → Any further contribution is to be approved by $\frac{3}{4}$ vote resolution

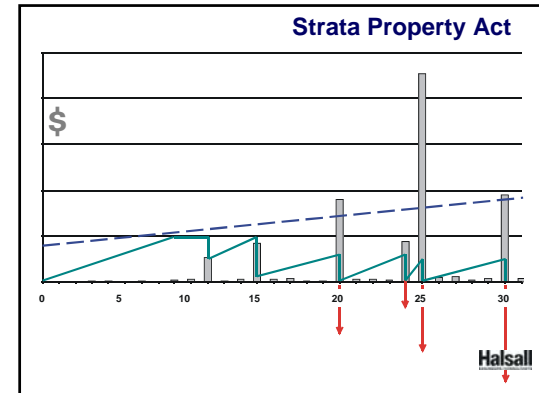
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Implications of following the requirements of the Act?


The Scenario: 100 unit Strata with annual operating budget of \$200,000.

- If CRF balance is less than \$50,000 (25%) Strata must contribute at least \$20,000.
- If CRF balance is between \$50,000 and \$200,000 Strata can contribute any amount.
- If CRF balance is over \$200,000 Strata cannot contribute to CRF unless they it is approved by $\frac{3}{4}$ vote.

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Contrasting Methods of Capital Planning: Depreciation (Component) Method vs. CRFS (Cash Flow) Method


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Depreciation (Component) Method

Depreciation Guidelines
Strata Property Act S.B.C. 1998

Annual Reserve Contributions = $\frac{\text{estimated cost} - \text{past contribution}}{\text{expected life}}$


- Basically considers a "separate" reserve amount for each item
- Calculates if Fund is "adequate": calculates "deficiency", "or catch-up"

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CRFS (Cash Flow) Method

A more detailed planning exercise and more complex method of analysis.

- Calculates annual expenses
- Establishes actual contribution necessary to provide sufficient funds to avoid a deficit
- "Critical Years" are estimates of when the reserve will be at an allowable minimum

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Component Method...Problems / Cash Flow Method...Advantages

- Component method **does not** account for Inflation or Interest earned
- Component method **does not** account for benefits of Cash Flow Analysis, or Critical Year Planning
- Component method **can over-estimate** annual contribution required

Cash Flow Method offers increased options for increasing funding: Abrupt or gradual increases.

Contingency Reserve Fund Studies

Qualifications

- BC has no qualifications
- Other Provinces: Qualified individuals or professionals (member of the Appraisals Institute, Architects, Engineers, CETs, and Quantity Surveyors)
- Bottom Line: People with experience in capital planning and system restoration. Must know buildings, how they deteriorate, capable of developing accurate budgets

Reserve Fund Study Structure

- [The Expense Model](#)
- [The Funding Model](#)



The Expense Model and The Funding Model

Expense Model

- Predicts magnitude and timing of expenditures
- Based upon standard service lives and/or evaluating actual performance

Funding Model


- How will the money be provided to meet the expenditures?

The EXPENSE MODEL:


Predicting Costs and Timing




Reserve Fund Expenditures



- "Major repair and replacement of the common elements and assets"
 - Material degradation
 - Loss of performance or appearance
 - Reliability
 - Safety
 - Legislated updates



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Identify Common Elements

- Structure
- Roofs
- Walls
- Windows
- Interiors
- Site
- Mechanical
- Electrical
- Elevators




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Understand Limits of Suite vs. Common Elements





- Strata Plan: Unit Boundary Definition
- Reciprocal / Cost Sharing Agreements
- By-Laws

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Understand Shared Facilities

- Identify shared elements
- Clarify how shared expenses are funded
- Identify zones requiring clarification



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Evaluate Conditions

- Technical review
- Identify failure mechanisms
- Special testing or investigation




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Evaluate Conditions

- Various management strategies
- Standard service lives - too conservative
- Develop solutions appropriate for the Strata




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Management Strategies



Best Performance...
usually higher initial cost

vs.

Least Initial Cost...
usually lower performance



Time Limits of Analysis

- In BC: No time limit specified in Strata Property Act – Consider minimum 30 years
- Costs beyond 30 years can be significant
- Limit to reasonably foreseeable future, building replacement not accounted for



Permitted “Upgrades”

Is adding a Roof Top Deck a permissible CRF expense?

Permissible upgrades:

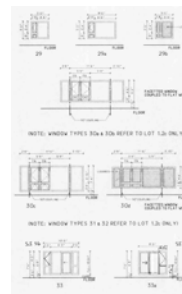
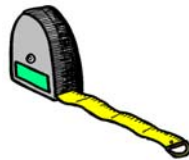
- Replacing with more durable or modern elements (eg: replace single glazed windows with double glazed).
- Required to correct a problem (eg waterproofing to stop deterioration).
- Strata should check with a lawyer if in doubt.

Budget Estimating and Degree of Accuracy

Budget Estimating

Quantity Survey

- Drawings
- Field Measurements
- Management Records

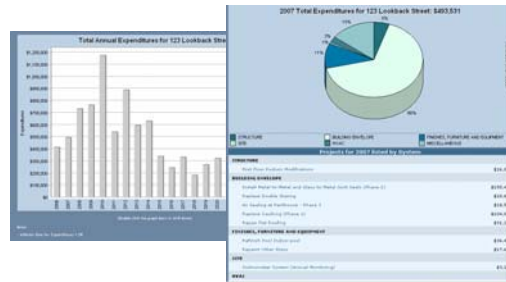


Budget Estimating

Cost Sources

- Published costing information
- Internal databases
- Management records
- Contractor quotations

Completed Expense Model



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Reserve Fund Study Structure

[The Expense Model](#) is complete

[The Funding Model](#) can begin



How will we raise enough money?
How much should we contribute to the CRF?

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The Funding Model

Parameters include:

- Expenditure Model Budgets and Timing
- Current contribution rate
- Starting balance
- Minimum tolerable balance for the Strata
- Inflation rate
- Interest rate

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Cash Flow Analysis

- Uses calculated annual expenses
- Establishes actual contribution necessary to provide sufficient funds to avoid a deficit
- "Critical Years" are estimates of when the reserve will be at an allowable minimum

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Minimum Reserve, Contingency

- Should maintain a minimum reserve
- Consider carrying a contingency item

These are **safety factors** for unexpected expenditures, or if average performance is poorer than estimated

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Cost Inflation

- Materials & labour costs increase over time
- Construction and material inflation rates are different than consumer price index

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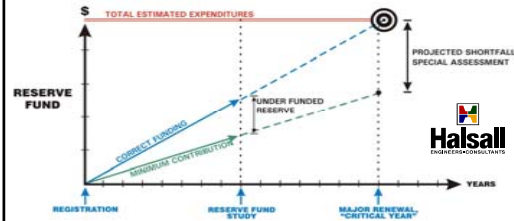


Investment Interest

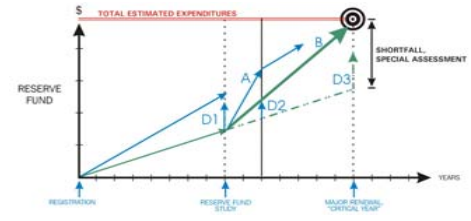
$$\text{Interest} - \text{Inflation} = 2-3\%$$

- Interest historically exceeds inflation by about 2 to 3%

How do you Develop a Fair Funding Plan?



Funding Options



A Fair Funding Plan:

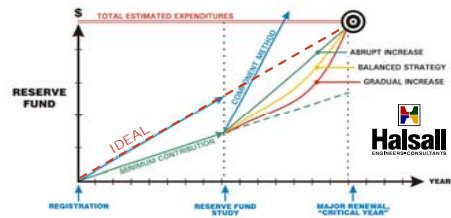
Balances interests of present owners
(tolerable immediate contributions,
sustained value)

with

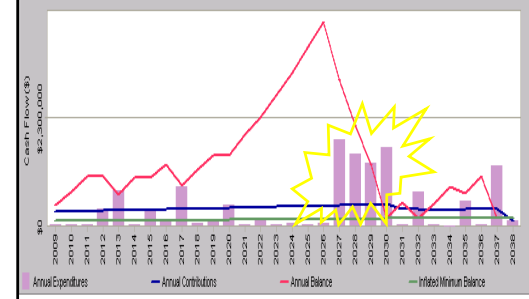
Interests of future owners (limit
future contributions & special levies)

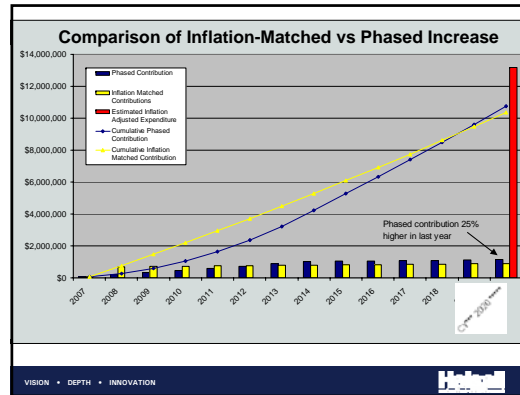
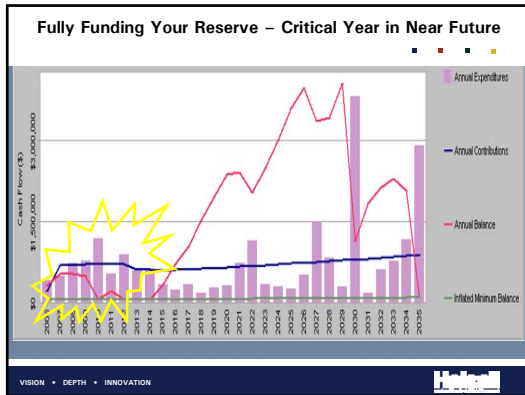


Full Range of Options for Increasing Reserve Fund



Fully Funding Your Reserve – Critical Year Far Away



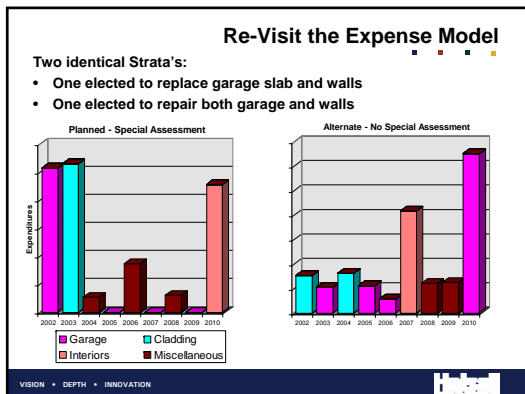


Options to Reduce CRF Contribution

- Confirm or investigate decisions & variables upon which the RFS is based – is more investigation needed?
- Defer major repairs... increase short term repair and maintenance to improve cash flow
- Identify specific components to be managed by a special levy
- Manage by special levy
- Limit the plan time frame

Most Options to Reduce CRF Contribution are likely to shift financial burden from present to future owners.

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Updating The Capital Plan

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When Should The Plan Be Updated?

- Internally by Building Owner annually
- Professional review about every 3 to 5 years
- If there are Building Changes
 - Changes in conditions
 - New or accelerated deterioration
- If there are Changes in Legislation:
 - window washing anchors, CFC phase-out, fire code retrofit, garbage recycling

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When Should The Plan be Updated?

- Changes in management objectives
- Changes in financial position:
 - Current reserve
 - Investment income
 - Surplus operation contributions to reserve
- Economic Changes: Inflation, Interest

Summary

Reserve Fund Studies are:

- A Process
- Engineered
- A Team Activity

Building Owner + Consultant + Manager

- Customized (decisions and results vary)



Summary

Reserve Fund Planning offers:

- Improved repair & replacement plans
- Encourage regular maintenance
- More stable, predictable funding
- Less chaos and stress

Summary

Until legislation changes in BC there are a range of funding options permitted, most of which are detrimental to the long term financial health of the Strata. The challenge for the Strata is how to get ¾ of the Owners to agree on which funding option to implement.

As Professionals we should:

- Take a holistic approach, step back and look at the big picture the next time you recommend a repair.
- Focus on providing Clients with a range of options to help them understand how their decisions today will impact their financial future.
- Understand how your recommendation will impact the Reserve Fund.

THANK YOU!

