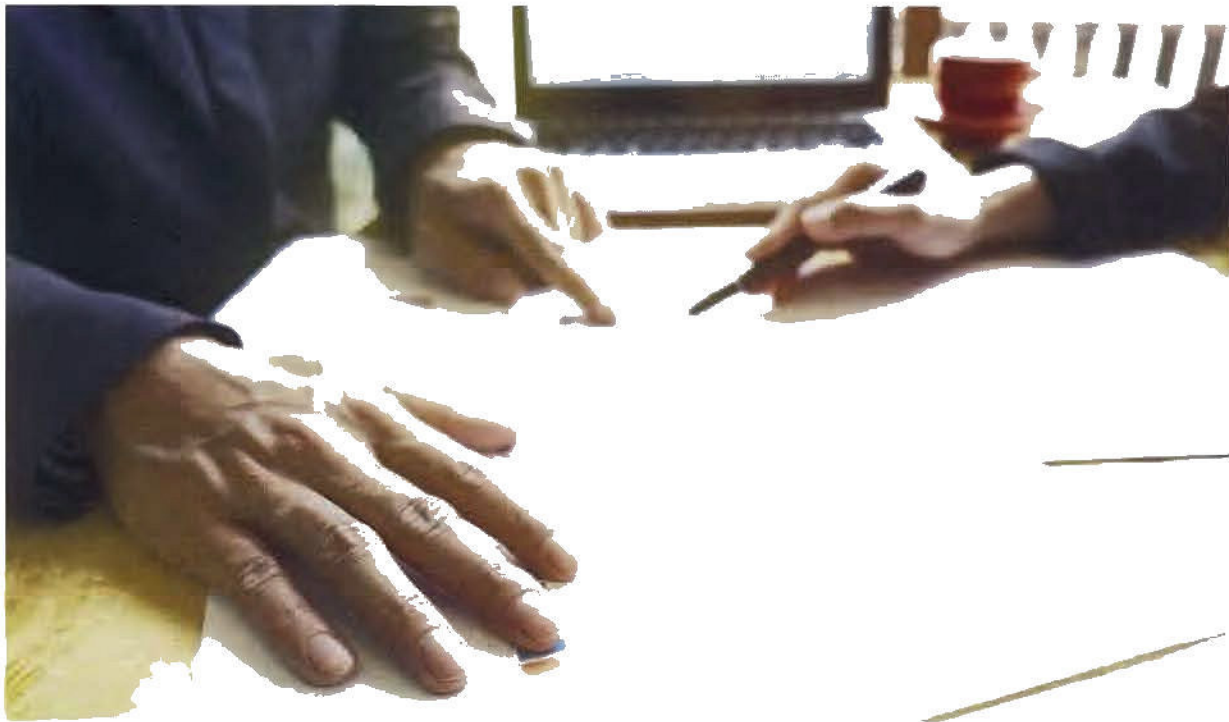


Understanding Your Reserve Study

BASIC PRINCIPLES

BY TOM GRESHAM, CRP

A Reserve Fund Study is essentially a financial plan. It is completed to ensure that adequate funding will be available for the major repair and replacement of the assets owned by a condominium corporation.



The reserve study should give consideration to all of the common elements including amenities, site features, furnishings, etc., as stated in the Corporation's Declaration and applicable bylaws. A current reserve study is required by provincial legislation. Minimum requirements are detailed in the Condominium Act, Newfoundland and Labrador Regulation 80/11.

Simply speaking, an effective reserve study should provide a clear picture of the present condition of the property, and estimate the timing and cost of future work that will be required. By factoring these with the present status of the reserve fund and projected economic conditions, a financial plan is created. This plan should outline the contributions that will be required by unit owners to ensure that the reserve fund will be neither overfunded, nor underfunded. This is of particular importance

to ensure fair contribution amounts for both present and future unit owners.

A reserve study can be broken down into two major components:

SITE ASSESSMENT

Key components of the site assessment include a thorough review of documentation, discussion with the board of directors and the property manager, and a visual evaluation of the property, building, and common assets.

Prior to the site visit, a review of documentation is completed. This includes the Corporation's declaration and bylaws, building drawings, site survey, prior maintenance history, prior reserve studies, and maintenance contracts. Points of

note are then discussed with the property manager, the board of directors, or the site representative as applicable. This provides the planner with a more accurate view of the applicable systems and components, quantities, areas where unanticipated expenses have occurred, and the concerns of unit owners prior to the site visit.

A visual evaluation is then completed by the planner to review and assess the property, building(s), and common assets of the corporation for condition. During the site visit each component is evaluated to determine six factors:

1. **Normal Life Span** (how many years it should last).
2. **Effective Age** (its condition, compared to what its condition should be for its age).
3. **Remaining Life Span** (the number of years until major repair or replacement is anticipated).
4. **Potential Deterioration** (conditions commonly observed with this type of component).
5. **Condition Analysis** (conditions presently observed with this particular component)
6. **Deficiency Analysis** (a description of reason(s) that a component has not lasted as long as it should as well as recommended actions).

After the site visit is complete, estimates for anticipated major repairs or replacements are compiled utilizing accountable methods. These may include recognized costing data, consultation with present service providers, quotes from local suppliers, and prior documented expenses. These estimates provide the basis for reserve fund financial planning.

FINANCIAL PLANNING

After the site assessment and component estimates are completed, a reserve fund "benchmark" is established. The benchmark establishes the following key factors, in addition to providing other pertinent information:

1. **Estimated Rate of Interest:** Research is completed to determine currently achievable rates of return on Bonds, GIC's, and other Government backed securities available to the Corporation. This is compared to the fund's prior investment performance to determine a realistic estimated return on future investments.
2. **Estimated Rate of Inflation:** Research is completed to determine the future estimated rate of inflation. This is completed by evaluating current and historical Construction Cost Inflation data published by sources such as Statistics Canada, with consideration given to future anticipated economic conditions.
3. **Future Replacement Cost:** This is the cost of repairs and replacements that will be required in the future, indexed for the anticipated amount of future inflation.

4. **Future Reserve Fund Accumulation:** This is the current reserve fund balance, adjusted to reflect the anticipated amount of interest gained in the future by the fund's investments.

5. **Future Reserve Fund Requirement:** This is essentially the amount that will be required to cover future expenses, in addition to the "Future Reserve Fund Accumulation".

This information is compared to the fund's current balance and contribution amounts to evaluate the adequacy of the reserve fund. A reserve fund is considered to be adequate when at a level which will ensure a positive balance in the reserve fund account throughout the projection period, after anticipated expenses are considered.

The planner may recommend an adjustment to contribution levels to ensure that contribution amounts by present unit owners are not greater, or less than the amount that is required to achieve a comfortable balance. Adjustment options should be discussed with, and ultimately decided on by the Corporation's Board of Directors. Different options may be considered or utilized, as long as adequate funding is ultimately achieved.

Available options may include a gradual long term adjustment to contributions, a short term more pronounced adjustment to contributions, or possibly a special assessment- although proper reserve planning should drastically reduce the need for consideration of this option.

Lastly, the Reserve Study document is prepared. This should include all pertinent information and recommendations in a format that is easy to understand, and that will serve as a valuable planning tool for use by the board of directors, and the property manager.

In accordance with legislation, a reserve study is required every 10 years in the Province of Newfoundland and Labrador. However, to achieve optimum effectivity, it is recommended that updates be completed at a more frequent interval to meet the standards that are legislated in other provinces.

Regular updating allows for adjustment based on changes in economic conditions, inflation, construction costs, building component condition, and other factors at a more frequent interval. This works in a similar manner to the theory of dollar cost averaging. This is of particular importance to ensure that contributions are not greater than, or less than what is actually needed to ensure fairness to present day, and future unit owners.

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