

# real estate

## **Condo-Ology®: A former front line condo manager's perspective**

### *Condominium Reserves: The Root of all Evil or Root of all Good*

Condominium ownership is a lifestyle and is a relatively new lifestyle as the first Ontario Condominium Corporation was registered in 1973. This new lifestyle includes many new and unique aspects specifically to condominium ownership. One unique aspect of the condominium lifestyle is that there is mandatory and legislated financial approach (obligation) of the condominium corporation of financial planning and saving for future major repairs and replacements. This is commonly referred to as the condominium corporation's reserve fund.

Each condominium reserve fund is monitored through periodic studies known as reserve fund studies. Ontario's current Condominium Act (Section 94.1) describes the purpose of reserve fund studies, *"The corporation shall conduct periodic studies to determine whether the amount of money in the reserve fund and the amount of contributions collected by the corporation are adequate to provide for the expected costs of major repair and replacement of the common elements and assets of the corporation"*.

The following discussion provides a brief history with regard to reserve funds and reserve fund studies. In addition, I will attempt to summarize the past successes and failures of the Ontario Condominium Act ("Act") specific to reserve funds and reserve fund studies and identify opportunities moving forward.

Prior to the current Act (which came into effect in 2001), condominium corporations were legislated to contribute an annual minimum amount of 10% of the annual operating projected costs into the corporations reserve fund account. The Board of Directors ("board"), which acts on behalf of the owners in regards to the operations of the condominium corporation, historically dealt with reserve fund funding in one of two ways: proactively or reactively. The proactive boards authorized reserve fund studies and complied with the reserve fund studies recommendations even though they were not legislated to do so. In contrast, the reactive boards adopted the minimum requirement even though they knew that

the funds would not be sufficient. Many boards, if not the majority of boards, adopted a reactive style.

The underlying logic of the reactive style was based on three main considerations: 1) an owner can typically achieve a greater return on their funds as opposed to the return generated on the collective reserve fund, 2) by adopting the minimum requirement, monthly common element fees (commonly referred to as “condominium fees”) were kept artificially low, and 3) the belief that major repairs or replacement should not be treated any differently for a condominium relative to a detached (freehold) home.

The reactive approach to reserve funds caused some major issues. The majority of condominium owners did not have access to a pile of cash should a reserve fund expenditure arise. Therefore, condominium owners of a reactive board were often shocked as inevitable repairs or replacements funds were needed – the most extreme situations became publicized horror stories.

The problems associated with the reactive approach of boards resulted in the inclusion of legislated reserves fund studies in the current Act. However, this change in legislation was not instantaneous as it allowed for a phase-in period. More specifically, the current Act allowed existing (pre 2001) condominium corporations a ten-year period to phase-in the necessary contribution increases to meet the reserve fund balance requirements as per the Act. Furthermore, as a result of the introduction of HST in 2010, an additional five years was added to the phase in period.

The end of the phase-in period for condominium corporations to comply with the Act is 2016 or 2017. At such time, all condominium corporations reserve balances must be sufficient to cover all future projected major repairs and replacements. Any short fall in the corporations reserve fund must be topped up immediately as future annual reserve fund contribution may only include inflation increases year after year.

Even though the current Act legislates the undertaking of reserve fund studies, boards are not currently legislated to comply with the study’s recommendations. If a board chooses to not comply with the study’s recommendations, the board is legislated to put forth their own reasonable plan. Another key consideration is that under the current Act, a board does not require the consent of the owners to make an expenditure out of the reserve fund.

As the condominium universe moves forward with the ongoing Act Review, reserve funds and reserve fund studies should be a front and centre topic. The Ontario government has acknowledged the past failure of the 10% minimum requirement and that the inclusion of mandatory reserve fund studies within the current Act constitutes a substantial improvement. However, there are many concerns with respect to the management of condominium corporations’ reserves that remain.

Some of the most notable issues moving forward include, but are not limited to, the accuracy of the reserve fund studies, compliance, general comprehension, costs, implementation and the impact on condominium fees. The impact on condominium fees is an important issues and there is a wide spread misconception that condominium fees are strictly to cover the day-to-day operations of a condominium corporation. This is simply not true. If properly managed, condominium fees should incorporate contributions to the reserve fund in order to ensure an up-to-date balance.

As noted at the beginning of this article, reserve funds are a unique aspect of the condominium lifestyle. This is not a negative characteristic; rather, this aspect of the Act should be embraced. If properly administered, a reserve fund ensures that there is no need for owners to scramble for cash for major expenses or replacements, as is the case for many detached (freehold) house owners.

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