

Understanding Strata Depreciation Reports

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The following information is general in nature and cannot be construed as legal advice on for any specific individual or transaction.

Updated October 2014

Outline

- a) Legal Requirements for Strata Depreciation Reports
- b) Overview of a Report
- c) Understanding and Interpreting Reports (Allan)
- d) New Problems
- e) Liability for Agents
- f) Critical Questions for Home Buyers when reviewing Reports



Managing Contingency Expenses

A contingency reserve fund is established to pay for extraordinary expenses, but under the Act, the amount in the CRF was established by a formula (which had NO relationship to the age of the building!)

Furthermore, the amount of contribution to the CRF was CAPPED, unless an $\frac{3}{4}$ vote was obtained to had additional contributions (hard to plan for the future).

Push for “Legislated Prudence”: long term planning and maintenance will prolong the lifecycle of building systems and reduce premature failure.



2009 Amendments

- Strata Councils required to commission a Strata Depreciation Report (aka Reserve Fund Study (ON/AB))

A report that tells you:

- What you own
 - How much money you have
 - When things need to be replaced
 - What it's going to cost for future replacement
 - What you can do to pay for future replacement
-
- Similar to other Canadian provinces (incl AB and ON)
 - Cookie Jar Savings Analogy



New Legal Requirements

Strata (with 5 or more units) Required to Commission a Strata Depreciation Report

- Existing Strata: by DEC 13, 2013 to:
 - Obtain Report
 - Pass s.94(3) resolution
 - $\frac{3}{4}$ vote
 - Only 18 month exemption
- New Strata: within 18 mo. of 2nd AGM

Does NOT create a separate fund (expenditures still funded by CRF or Special Levy)
- the “cookie jar analogy” does not legally apply

Required to update reports every three years (AB every 5).



Exemptions and Waivers

Two Exemptions

1. Strata corporations with fewer than 5 strata lots are not required to obtain the report nor hold a $\frac{3}{4}$ vote to exempt themselves;
2. Strata corporations with more than 4 strata lots can release themselves from the obligation to obtain a report for 18 months by obtaining a $\frac{3}{4}$ vote at an AGM or SGM.



Overview of a Report

- a) Physical Inventory of Assets
- b) Evaluation based on on-site Inspection
- c) Repair, Renewal and Maintenance Costs for a 30 year plan
- d) Assumptions
- e) Three Year Cash Flow Models



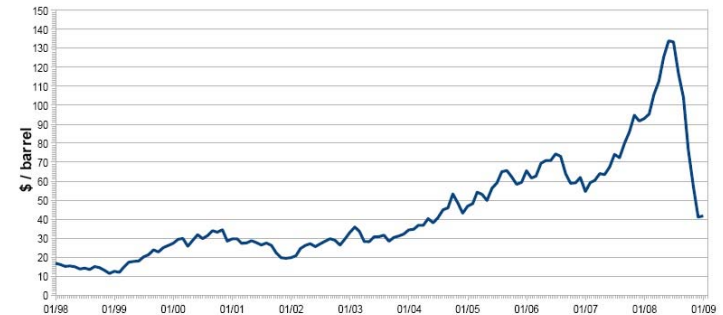
Reports can vary

- a) Component Cost changes (ie; price of oil/ metals)
- b) Construction Cost Index v. CPI (do not trend together)
- c) Study does not carry out destructive testing (things can be mixed)
- d) Varied of backgrounds in qualified persons

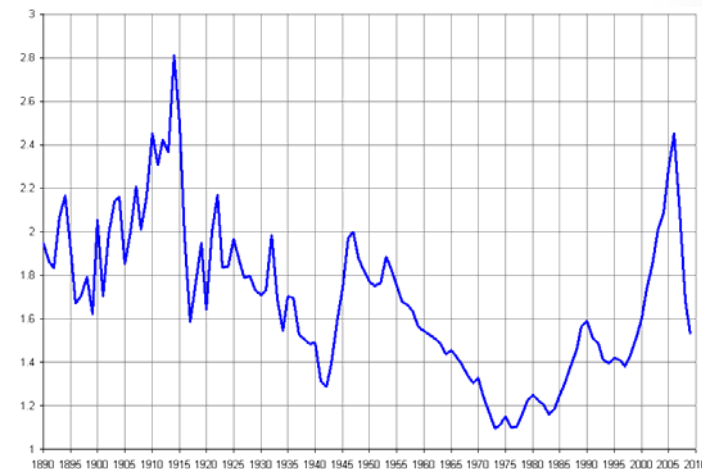
Reports are a “PLAN” – they are not fixed in stone...

Crude Oil Prices 1998 – 2009

(West Texas Intermediate – monthly averages)



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Home Buyers and Depreciation Reports

- Reports Are a **MANDATORY** attachment to the **Form B** with now must also include:
 - The rules of the strata corporation;
 - The current budget of the strata corporation;
 - Any rental disclosure statement;
 - Parking Stall and Storage Locker information;
- Reports Are a **BUDGETING** tool, so it is important to look for agreement between the report and the strata actions.
- Interpreting this Technical Document
 - <http://kent-macpherson.com/services/depreciation-report/3271/>





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***Depreciation Reports
in British Columbia
Early Results***



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Outline

- Regulation and Scope of DR Reporting
- Basic Components of a DR Report
- Benefits
- Challenges
- Results
- Red Flags

Acknowledgement of Material Use: Condominium Home Owners Association





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The Current Status

Scope

Strata Property Statistics in BC

- 27,775 Strata Corporations (August 31, 2010)
- Estimate 970,000 strata units
- Estimate 22,000 qualifying strata corporations
- Estimate 770,000 qualifying strata units

Acknowledgement of Material Use: Condominium Home Owners Association





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The Current Status

Regulation requires:

- Three models
- Minimum 30 year time horizon
- Disclosure of relationship
- Confirmation of insured status

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Purpose of a Depreciation Report

To Establish:

- What you own
- How much money you have
- When building systems need to be replaced
- What it's going to cost for future replacement
- How to prepare your financial plan for the future

Acknowledgement of Materials Use: Condominium Home Owners Association





The Report Will Include:

- A physical inventory of all common property including building systems
- Expected maintenance, repair and replacement costs for common expenses proposed over 30 years
- Financial forecasting, including at minimum, three cash flow models for the contingency reserve fund (CRF)



Benefits

- Maintain the value of the overall property
- Even out the necessary contributions required over many years to cover future replacement costs
- Create a secure and fair financial plan
- Proactive preparation = well organized management
- Familiar with the life expectancy of all of the services



Documents and Records:

- Operating budget
- Current balance sheet, including the contingency reserve fund balance & any investments & assets
- Current insurance certificate or insurance appraisal
- Prints, plans & drawings - architectural, structural, mechanical, electrical, fire protection & other



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Benchmark Analysis

	C	D	E	F	G	H	I	J	K
RESERVE COMPONENTS	EXPECTED	EFFECTIVE	REMAINING	CURRENT	FUTURE	CURRENT	FUTURE	FUTURE	ANNUAL
	LIFESPAN	AGE	LIFE SPAN	REPLACEMENT	REPLACEMENT	RESERVE FUND	RESERVE FUND	RESERVE FUND	RESERVE FUND
	Years	Years*	Years	COST	COSTS	REQUIREMENTS	ACCUMULATION	REQUIREMENTS	ASSESSMENT
Construction Cost Inflation Index	2.25%								
Interest rate	1.90%								
BUILDING - STRUCTURAL/ARCHITECTURAL									
1 Foundations and Parking Garage	30	17	13	21,688	28,962	12,290	15,696	13,266	909
2 Superstructure & Building Envelope - Walls	40	15	25	174,325	304,048	65,372	104,652	199,397	6,305
3 Windows and Doors	35	15	20	70,400	109,860	30,171	43,962	65,898	2,739
4 Roof Cover - Torch-on	25	3	22	158,730	258,972	19,048	28,819	230,153	8,525
5 Roof Cover - Asphalt Shingle	25	17	8	100,700	120,319	68,476	79,603	40,716	4,761
COMMON AREAS AND FACILITIES									
6 Flooring	15	6	9	90,000	109,954	36,000	42,645	67,309	6,928
7 Interior Finish	10	5	5	59,000	65,943	29,500	32,411	33,532	6,456
8 Furnishing and Decorating	15	5	10	10,000	12,492	3,333	4,024	8,468	777
9 Elevators	40	17	23	202,500	337,817	86,063	132,684	205,132	7,195
BUILDING SYSTEMS									
10 Plumbing	25	15	10	73,325	91,598	43,995	53,106	38,492	3,531
11 Electrical	30	17	13	43,991	58,747	24,928	31,839	26,908	1,844
12 HVAC	25	12	13	85,500	114,180	41,040	52,417	61,763	4,233
13 Life Safety & Access Systems	25	17	8	75,000	89,612	51,000	59,288	30,325	3,546
14 Water and Sewer Supply System	50	17	33	35,000	72,939	11,900	22,146	50,793	1,121
SITE IMPROVEMENTS & PROFESSIONAL FEES									
15 Landscaping, Irrigation and Fencing	35	17	18	32,250	48,136	15,664	21,981	26,155	1,232
16 Roadways, Surface Parking and Sidewalks	30	17	13	29,559	39,474	16,750	21,394	18,081	1,239
17 Professional Fees	30	0	30	33,100	64,525	-	0	64,525	1,616
TOTAL RESERVES				\$1,295,067	\$1,927,578	\$555,530	\$746,666	\$1,180,912	\$62,957

*Effective age may not match chronological age if the component is in better than average condition.



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30 Year Cash Flow Projection (Years 1-15)

	Year 2013	Year 2014	Year 2015	Year 2016	Year 2017	Year 2018	Year 2019	Year 2020	Year 2021	Year 2022	Year 2023	Year 2024	Year 2025	Year 2026	Year 2027	
Reserve Estimate	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	
OPENING BALANCE	293,000	340,817	400,055	437,057	501,931	540,447	545,849	567,560	562,750	537,685	513,779	601,541	690,970	779,998	872,818	
Reserve Fund Contributions	50,250	52,763	55,401	58,171	61,079	64,133	67,340	70,707	74,242	78,000	78,000	78,000	78,000	78,000	78,000	
Reserve Fund Interest Income	1.90%	5,567	6,476	7,601	8,304	9,537	10,268	10,371	10,784	10,692	10,216	9,762	11,429	13,128	14,820	
Total Cash Resources	348,817	400,055	463,057	503,531	572,547	614,849	623,560	649,050	647,685	625,901	601,541	690,970	782,098	872,818	967,402	
RESERVE FUND EXPENDITURES																
1 Foundations and Parking Garage	12,290									9,022						
2 Superstructure & Building Envelope - Walls	65,372									56,100						
3 Windows and Doors	30,171				15,700					17,600					19,700	
4 Roof Cover - Torch-on	19,048															
5 Roof Cover - Asphalt Shingle	68,476	8,000					54,200	55,100								
6 Flooring	36,000								110,000							
7 Interior Finish	29,500					69,000										
8 Furnishing and Decorating	3,333							6,000								
9 Elevators	86,063															
10 Plumbing	43,995				16,400					18,300					20,500	
11 Electrical	24,928									5,500					12,300	
12 HVAC	41,040															
13 Life Safety & Access Systems	51,000		26,000												34,900	
14 Water and Sewer Supply System	11,900														10,000	
15 Landscaping, Irrigation and Fencing	15,664							19,300								
16 Roadways, Surface Parking and Sidewalks	16,750															
17 Professional Fees	0			1,600			1,800	5,900		5,600			2,100			
Total Expenditures	8,000	0	26,000	1,600	32,100	69,000	56,000	86,300	110,000	112,122	0	0	2,100	0	97,400	
Closing Balance	340,817	400,055	437,057	501,931	540,447	545,849	567,560	562,750	537,685	513,779	601,541	690,970	779,998	872,818	870,002	
DEFICIENCY ANALYSIS																
Reserve Requirements	555,530	547,530	620,890	669,645	743,725	788,714	797,657	819,770	812,003	780,388	746,051	823,183	901,781	979,772	1,061,345	1,047,068
Reserve Fund Surplus	-206,713	-220,835	-232,588	-241,794	-248,266	-251,808	-252,210	-249,252	-242,703	-232,272	-221,643	-210,811	-199,774	-188,527	-177,067	



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Townhomes- Mixed Semi Detached & Single Family





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Townhomes- Mixed Semi Detached & Single Family

	Example A	Example B	Example C
Storeys	Single	Single	Single
Unit Count	67	57	6
# Buildings	59	15	3
Age	20 Years	26 Years	19 Years
Amenities	Clubhouse, Pool, Waterway, Fountains	Activity Centre, Pool	None
Current CRF	\$94,600	\$78,500	\$4,320
Recommended CRF	\$468,715	\$405,000	\$72,290
Current Annual Contribution Average \$ per Unit per Month	\$5,000 \$6.22	\$21,000 \$30.66	\$3,600 \$50
Recommended Contribution Average \$ per Unit perMonth	\$40,000- \$71,835 \$49.75-\$89.33	\$40,000-\$57,000 \$58.50-\$83.33	\$5,500-\$11,500 \$76.39-\$160
% Increase in Contributions	700%- 1336%	90%-170%	53%- %219%
Avg. Annual Increase Per Unit	\$597-\$1,045	\$702-\$1,000	\$917-\$1,917



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Apartment, Condominiums





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Apartment, Condominiums

	Example A	Example B	Example C
Storeys	4	3	4
Unit Count	25	126 + 3 guest suites	37
# Buildings	1	3	1
Age	34 years	20 years	11
Amenities	Elevator	Elevators, Club Hse, Meet. Rm	Elevator, Meeting Room
Current CRF	\$23,500	\$309,000	\$80,000
Recommended CRF	\$199,560	\$814,245	\$162,900
Current Annual Contribution Average \$ per Unit per Month	\$19,000 \$63.33	\$24,500 \$16.20	\$7,190 \$16.19
Recommended Contribution Average \$ per Unit perMonth	\$23,500 \$78.33	\$86,500-\$136,750 \$57.22-\$90.44	\$12,500-\$50,000 \$28.15-\$122.61
% Increase in Contributions	24%	253%-458%	74%-595%
Avg. Annual Increase Per Unit	\$940	\$687-\$1,085	\$337-\$1,351



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Bareland Strata, Single Family Townhomes





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Bareland Strata Single Family Townhomes

	Example A	Example B
Storeys	Mixed	Mixed
Unit Count	250	18
# Buildings	250	18
Age	5-9 Years	24 years
Amenities	Clubhouse, Pool	None
Current CRF	\$400,000	\$12,800
Recommended CRF	\$140,000	\$71,975
Current Annual Contribution Average \$ per Unit per Month	\$50,000 \$16.66	\$1,185 \$5.49
Recommended Contribution Average \$ per Unit perMonth	\$60,000-\$72,500 \$20.00-\$24.17	\$5,400 \$25.00
% Increase in Contributions	20%-45%	\$355%
Avg. Annual Increase Per Unit	\$240-\$290	\$300



Red Flags

- Special levy (or levies) – especially in short term
- Low cash balances (less than 25%)
- Major assets not on the list
- Low closing balance
- Unrealistic “factors”



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FAQ

- Do You Do Residential Appraisals?
- What Is An Appraisal?
- How Much Does An Appraisal Cost?
- What Is A Depreciation Report?
- When Is The Deadline For



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(Articles)

What Changes to B.C. Act Mean For A Strata

<http://www.housing.gov.bc.ca/strata/regs/IB-Accountability.pdf>

New Regulations Will Affect Strata's Annual Budget

http://www.choa.bc.ca/members/pdf/300/300-466_220112_New_Regulations_that_affect_your_annual_budget.pdf



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(Articles)

"Faulty Towers" Hidden Dangers of Low Condo Maintenance Fees

<http://www.theglobeandmail.com/news/toronto/globe-to/faulty-towers-the-hidden-dangers-of-low-condo-maintenance-fees/article2030464/page2>

Saying No To Depreciation Reports

http://www.choa.bc.ca/members/pdf/300/300-467_290112_What_if_we_just_say_NO_to_depreciation_reports.pdf

New Problems

Many legislative oversights:

- Funding a report not a requirement (may require SL with $\frac{3}{4}$ vote)!
- Following and implementing the report is not a requirement!
 - But... now the Act allows additional CRF contributions with a simple majority vote (to allow a Report to be followed).

Administrative Issues:

- Not enough “qualified persons” to do all the required reports
- Reports may be costly
- Lenders may require Reports in BC as pre-condition to funding.



What if the Study is Wrong?

Deference by the Court to the “forward looking” nature of the report:

- **Scotwick Realty Services Inc. v. The Owners: Condominium Plan No. 7510479 (June 11, 2003)**
- "Preparing a reserve fund plan that projects many years into the future is always going to be a bit of a guessing game. The exact timing of the expenditure and the exact quantum of the expenditure will always be an estimate only.";
- "The only conclusion that I can reach is that a board confronted with an unexpected expenditure then has a duty to revisit the reserve fund plan and make any necessary adjustments"



Liability for Agents

Pass on the Correct Information

Re Buchanan - Realtor misread Form B and drafted a “amendment” adjusting the Purchase Price by \$5000 for a special levy (which was not passed).

Re Cha – Realtor allowed Buyer to remove subject condition even though Buyers had no received Form B and strata docs.

Ensure Report is Complete

Meslin v. Lee – Seller, acting together with the Seller’s Agent, innocently misrepresented to the Buyer that there was no “engineer’s report” – Buyer entitled to rescind contract and return deposit.

Ensure there is no Misrepresentations

Hilman v. McKenzie – Realtor selling own property in Ft. McMurray to her client. Judge found that “once was a “Realtor” she was always a “Realtor” and must conduct herself in accordance with RECA rules and code. Seller (Realtor) knew that there were problems with the roof and fraudulently covered them up; b) provided and incomplete document package and c) represented that despite a note “deficiency” in the Contingency Fund, that the funds was sufficient. Court found that the Realtor was “reckless” (and careless). Damages and costs awarded to the Buyer.

Critical Questions for Home Buyers (and their Realtors)

1. Is the Form B complete (containing current Rules, Budget, Rental Disclosure, and Depreciation Report)
2. Do the Buyer understand the Report?
3. Has the strata deferred its Report obligations under s.94(3)?
4. Does the financial forecast in the Report and the strata budget align?
5. Should anything in the Report be reflected in the Purchase Price when analyzing comparators?



Thank you for listening...



- Questions are always welcome...
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