Money Matters and Reserve Funds

When is a Reserve Fund “Adequate”?

By James Davidson, LLB

Section 94(8) of the Condominium Act, 1998 tells us that the goal of reserve fund planning is to have a reserve fund that is “adequate.” To be more specific, section 94(8) says that condominium corporations must prepare a reserve fund plan “that the board determines will ensure that, within a prescribed period of time and in accordance with the prescribed requirements, the fund will be adequate for the purpose for which it was established.”

What does this mean? When is a reserve fund “adequate?” In my view, this is open to interpretation. Here are some of the possible answers:

1. The word adequate can have different meanings and therefore can mean different things to different condominiums. Section 94(8) says that it’s up to the board to arrive at a plan that the board determines will result in an adequate reserve fund. Therefore, it’s up to the board to determine what is “adequate” for the particular condominium. The board must ensure that the plan shows a positive balance in the reserve fund throughout the period of the plan.

2. A reserve fund is adequate provided the fund is “topped up,” so that the reserve fund is not “behind.” The amount in the fund must not be less than would be in the fund if the reserve fund contributions had been perfect throughout the life of the condominium and the condominium had experienced no early or unexpected expenditures. In other words, the reserve fund must be brought into line with a hypothetical fund that has always been kept perfectly on track. Once this point is reached, the contributions can then continue at a natural level for the building – just as if the reserve fund planning and the repair and replacement had always stayed perfectly on track in the particular condominium.

I prefer the following interpretation.

In my view, the overall idea behind reserve fund management is to arrive at contributions that can remain constant from year to year. I believe that the ultimate goal of reserve fund planning is to avoid increases/special assessments. Therefore, I believe that a reserve fund is adequate when the contributions are such that they can be kept constant. (By “constant,” I mean that the contributions increase by inflation from year to year. Increasing the contribution by inflation keeps the contribution constant, in real terms.) Once the reserve fund contributions meet this test – that they can remain constant – the results are as follows:

A. There would be no need to refer to the reserve fund contributions in paragraph 12 of the status certificates, because the contributions would not represent a risk of an increase in common expenses. If a reserve fund plan calls for the contributions to increase beyond inflation at any time in the future, this must be disclosed in paragraph 12 of the status certificates. (Even
though the plan – the Form 15 notice to owners – is attached to the status certificate, purchasers must also be specifically warned, in paragraph 12, if the common expenses may increase beyond inflation at any time in the future.) One of the key goals of condominium financial management is to have a clear paragraph 12. In my view, the reserve fund is not adequate if the corporation must include a warning, in paragraph 12, that the reserve fund contributions may increase beyond inflation.

B. If the reserve fund contributions can remain constant, this means of course that the contributions henceforth will not be greater – or less – than the present contributions (assuming things unfold according to the plan). In other words, the plan calls for the reserve fund obligations to be equalized from that date forward. In my view, this is a key goal of reserve fund planning. One of the primary purposes of the reserve fund is to equalize the costs of long-term repair and replacement from year to year. This is essentially a state of equilibrium, between current owners and future owners, as far as it concerns the cost of long-term repair and replacement. Again, I consider this to be a fundamental element of reserve fund planning. As you can see, I don’t believe that the reserve fund must be topped up to ideal levels, but I do feel that the board is bound by certain key principles. As I have said, the test is as follows: a reserve fund is adequate when the contributions reach a level at which they can remain constant (increasing only by inflation from year to year thereafter), and of course provided this is expected to result in a positive balance (including a reasonable buffer for contingencies) throughout the life of the plan. Note that the requirement is that condominium corporations plan for an adequate reserve fund. It’s not possible to ensure that the reserve fund will always be adequate, because things don’t always go according to plan. Condominium corporations can be knocked off track by actual or anticipated events that are not in keeping with the reserve fund plan. When corporations are knocked off track, they must:

• Plan to get back on track with reasonable haste;
• While they are off track, consider the need to include a warning in paragraph 12 of status certificates.

One added note: according to section 33 of Regulation 48/01 under the Condominium Act, 1998, corporations created before the new Act came into force have a 10-year period of grace. That is, they have 10 years (from the date of the corporation’s first reserve fund study conducted under the new Act) to bring the reserve fund on track. Those corporations must prepare a plan that calls for the reserve fund to be adequate within that 10-year period. And until the reserve fund is adequate the corporation’s status certificates must contain a warning – in paragraph 12 – that increases beyond inflation are anticipated.

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