

Effective communications is an excellent starting point when managers and their boards tackle preparation of the yearly budget.





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Failure to Budget Effectively?

A Look at the Basics

This article reviews the fundamentals of a Reserve Fund Study and whether capital expenditure on repairs should be delayed, but first let's look at how to budget effectively, and consider the surrounding aspects such as communication. Communication plays an important role in assisting property managers and boards of directors to provide better communal living.

Budgets

The purpose of the budget is to determine the next fiscal year's (12-month period) expected revenues and expenditures and to make provision for reserves and long-term expenditures. The budget is prepared where every item begins with zero dollars and is balanced with both the revenues and expenditures. The

approved budget sets the maintenance fees to be paid by the owners for the upcoming year.

Budget Preparation Process

The property manager creates a "draft" budget with input from the board of directors a few months in advance of the fiscal year end. The budget is then studied, debated, voted upon, and finally approved and signed-off by the board. The owners cannot vote on the budget since the budget is the responsibility of the board alone.

In the process mentioned, the board is responsible for reviewing the amounts of revenue and expenses presented by the property manager, and for determining that the numbers are reasonable based on past history. Any new items should have

proper references. The board should also confirm that the numbers are calculated properly. An additional function is to provide a recommended list of projects (i.e., wish list) and determine whether the budget can financially sustain them during the next fiscal year or whether some should be deferred. In other words, will there be sufficient income to cover the planned expenditures. Expense elements of the budget include the sum of the expenses, reserve fund contribution and surplus required. Income elements include owners' maintenance fees and supplementary sources of income. For further information on the specifics in your corporation, consult with your property manager and/or auditor.

The new *Condominium Act* requires that budgets be given to owners at

least 15 days before the new fiscal year. Management companies usually achieve this deadline by sending the budget to the owners a minimum one week prior to the deadline. Counting back, approval of the budget by the board should be completed a minimum of twenty-five days prior to the deadline. Providing owners with the budget gives greater transparency to the board, and allows owners to decide if the property is being properly managed.

In addition to the budget, the mandatory preparation of a reserve fund budget must be prepared each year and sent to owners. New regulations require the board to notify owners of expenditures, which significantly vary from those forecast in the budgets. A more detailed look at the reserve fund is covered towards the end of this article.

Communication

Effective communication strategies during the budget process go a long way in balancing differing viewpoints expressed by owners, and will ensure budgets are completed in a timely manner. Below are outlined some suggestions for developing the essential communication among board members:

1. Develop, if possible, a shared vision and/or common goals for the corporation. Remain focused on it from board to board as a way for maintaining the condominium's best interest.

2. Facilitate meaningful communication with the goal of reaching a consensus. Respect fellow board members, and their opinions. Take the time to create an environment for effective communication. Ensure that there is a Code of Ethics. Effective board members know and follow the

rules and ensure that there is consistent and courteous behaviour within their community.

3. The board should take active steps with courteous enforcement and compliance to protect their community

4. Follow the *Condominium Act* by consulting with qualified professionals within each discipline for more concise information upon which the board can make an informed decision.

5. Ensure that each board member has all the information required to reach a decision on the budget and set timelines with soft and hard deadlines. Once all the required information is obtained, including recent financial statements, previous budget statements outlining present and historical expenditures, up-dated arrears, and management reports on issues requiring board decision, the board can make an educated decision based on the information.

6. A board can ensure transparency by having owner information sessions, websites with timely information, newsletters, etc., all of which should enhance understanding and trust of the board.

Reserve Fund

As the Reserve Fund also plays an integral part of the budget, the remainder of this article will look at the basics of this study. The Reserve Fund is an independent study that identifies when various components of the common elements might require repair or replacement, and how much must be collected from the unit owners on an ongoing basis in order that sufficient funds will be available to perform those replacements and/or repairs when that time arrives.

A comprehensive Reserve Fund Study consists of both a physical and a financial

analysis of the common element components. The physical analysis reviews the condition of common elements and makes an assessment of each component. The assessment includes the present age, the expected useful life, and expected actual life to replacement. The financial analysis describes the financial condition of the Reserve Fund and the estimated costs for future replacement and repairs. An assumed inflation rate and estimated interest earned by the fund is considered during the independent study. The result of the study is to recommend an amount of present day contributions to meet the future needs of the fund.

The Reserve Fund's "balance" alone is not representative of the corporation's financial health. The balance will fluctuate from year to year relative to previous contributions and the year's capital expenditures. In order to verify the reserve adequacy, one should also consider other elements and factors such as the minimum closing balance per unit, maximum closing balance per unit, monthly contribution per unit, current cost per unit, adequacy confidence ratio, adequacy direction ration, condition index and/or funding index. If a person requires more information he/she should speak to their Reserve Fund Planner.

If prepared correctly, the Reserve Fund has been set in place and used as recommended in the study. The Fund cannot be used for any purpose other than for major repairs and replacement of the common elements, and for the reserve fund study itself. Deferring repairs and/or holding repairs over to the next three or more years may escalate the cost of repairs and have an adverse impact on



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the reserve. An example of this would be when deterioration of a component has escalated along with the cost of materials and inflated labour rates.

Interest earned by the Reserve Fund must remain within the Fund. It should never be transferred into the corporation's operating account. Contributions to the Reserve Fund are primarily from the maintenance fees paid by owners. Other sources might be operating surpluses, special assessments, loans and other contributions that may be deposited into the reserve fund.

Ontario condominium law requires the reserve fund study to be updated every three years. Site inspections are required for alternating updates to the Reserve Fund. Reserve Fund Study updates should be considered at other times too:

- When significant changes to the asset inventory occurs;
- When the actual reserve balances are too low or when there is a large difference between the predicted required balance and the actual balances; or
- If the actual expenses are much higher than the predicted expenditure.

Reserve Fund updates must be based upon verification of the corporation's records, and interviews with representatives, directors, agents, etc. of the corporation such as the conductor of the Reserve Fund deems appropriate. The regulations made under the *Condominium Act* set out specific professionals and requirements in order to perform the independent reserve fund study.

The *Condominium Act* requires that, within 120 days of receiving a Reserve Fund update, the board must propose a plan for funding the Reserve Fund. Subsequently, within 15 days after the proposed plan has been developed, the board must send notice to the unit owners containing a summary of the study, a summary of the proposed plan, and a statement indicating areas, if any which differ from the study. The board must send the auditor a copy of the study, a copy of the proposed plan and a copy of the notice sent to the owners. When 30 days have passed, the board shall then implement the proposed plan.

Section 94 of the *Condominium Act* also indicates that within the 120 days

mentioned above, the board must determine 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.

In summary, effective communication is an essential component of a Reserve Fund Study and Budget. Deteriorating conditions should be treated when discovered. Delay will be more costly to the condominium in the long run.

A well prepared Reserve Fund Study, an intelligently planned budget, a well maintained facility and a proper communication channel will set the platform for a financially stable, marketable and well maintained condominium. ■

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