10 Myths Delaying Depreciation Reports

By David Albrice

Listed here are the most common reasons I have heard some owners use for delaying the commissioning of a Depreciation Report (also called a Reserve Study or a Capital Plan). I have included some reasons why these are based on false assumptions.

Myth 1: We are a young building and don't need a capital plan until we get older.

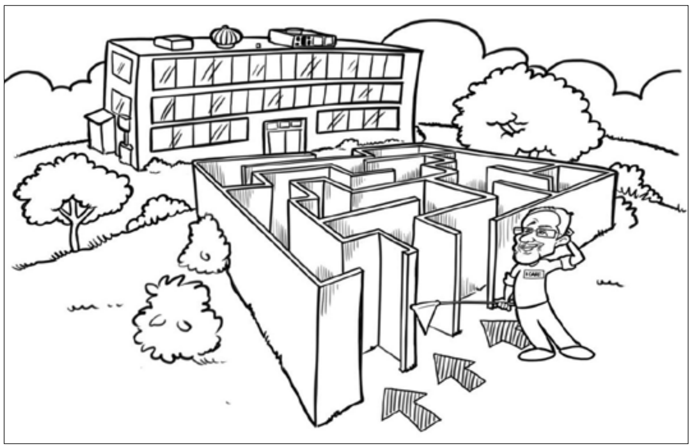
Young buildings often find themselves going through a "teething" process, which includes warranty reviews to protect against any construction defects and adjustments to financial operations to address the artificially deflated marketing budgets established by some developers. Here are some more things to consider:

- The depreciation report provides advice on major maintenance activities to help extend the life of the young assets and these maintenance activities are most effective if started early in the life of the building.
- The report identifies the 2-5-10 warranty cycles that are paramount for consumer protection during the early years of the building.
- Young buildings are in the envious position of being able to leverage the power of the compounding effect of interest income that can be earned in the reserve account. Small adjustments early in the life of the building will have a positive impact down the road.

Myth 2: We are a townhouse complex and don't have many assets to worry about.

While it is true that many townhouses include assets that are not part of the common property, such as furnaces and water heaters, these types of developments have some unique features. Here are a few things to consider:

- Townhouses have significantly more roof area, exterior wall area and roadways, per unit, when compared to low-rise buildings and high-rise developments. While there may be fewer assets, they are larger in size.
- There is a lot of buried infrastructure under the roadways and around the perimeter of each building, which is not readily apparent. This includes storm water pipes and sanitary pipes that typically last several decades but will be costly to replace.
- The depreciation report identifies the necessary major maintenance cycles to protect the owners' investment. For example, camera scoping surveys of the drain pipes, to detect any root intrusion and sediment build-up, can save many thousands of Dollars from water damaged basements and crawl spaces.



The price of light is less than the cost of darkness. This is a call to action for 5000+ buildings in British Columbia.

Myth 3: We are a small building with few units so it is not affordable for us.

It is unfortunate that smaller buildings do not enjoy the economies of scale of larger building where costs are distributed across a larger number of owners. Some things for small buildings to consider:

- It is not unreasonable for the report to be restructured to match the scale and complexity of the smaller building. This can result in reducing the professional fees.
- Think about gathering as much data as you can to reduce the amount of time that the consulting team needs to spend on the building. A committee of some of the owners can work closely with the consultant to facilitate the report.

Myth 4: We are waiting for the professional fees to come down.

Some people assume that consulting fees have been artificially inflated as a result of the demand created by the legislated requirement to commission a depreciation report. A few things to consider:

- It requires a team effort to prepare a good depreciation report and the prime consultant will sometimes need to engage the services of specialized sub-consultants. The total fee is therefore applied across various professionals, each of which has their own fee structure.
- The consultants are required to conduct an on-site visual inspection and meet other standards stipulated by the local regulations. The preparation of a depreciation report is a significant undertaking that cannot be taken lightly.
- The first "wave" of reports was completed within the deadline stipulated in the regulations and now there is a new wave of update reports that are being requested by the early adopters. While the fees cannot be reduced, the turnaround times are improving as the consulting firms have become more efficient in preparing the reports and have arranged additional resources to meet the demand.

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Myth 5: We are too scared to see the results, which will make our lives miserable.

Some owners assume that the report will inevitably bring bad news that will end up costing them more money. Here are fact checks to bear in mind:

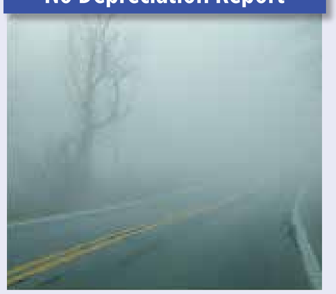
• The majority of reports have indicated that the owners have been reasonably diligent in maintaining their buildings. A good report card provides peace of mind.

• No building is immune from large capital projects, regardless of how well built and how well maintained. Burying our heads in the sand does not make the projects go away.

Many real estate agents have posted blogs expressing the opinion that it is better to have a report than not to have one.

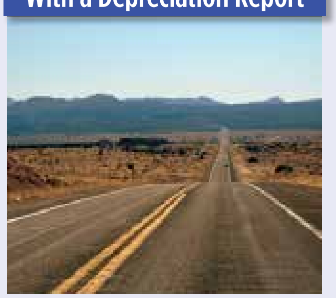
• The owners have the final say in how they spend their money. The report provides information so that the owners can understand the risks and make informed decisions.

No Depreciation Report



Lots of surprises; not much peace of mind.
"Failing to plan is planning to fail."

With a Depreciation Report



Few surprised; peace of mind.
"Plan the work and work the plan."

Myth 6: We think it is a witch-hunt and don't trust the consultants will be fair and reasonable.

Given the "leaky condo" crisis in British Columbia, it is understandable that some owners lost confidence in the quality of construction. Here are some things to take into consideration:

• Engineers, and other regulated professionals, are bound by a code of professional ethics to be impartial. A good consultant endeavours to provide a report that makes reasonable forecasts of future projects and includes defensible estimates of these costs.

• The report must include disclosure of all methods and assumptions so that these can be reviewed and validated. This responsibility is not taken lightly and gives the owners "open book" access to the data collected by the consultant. Ask your consultant for references so that you can get input from other owner groups who ventured forward with their reports.

• A good report will not only help the owners plan for the eventual end-of-life renewal projects but will also provides useful information on maintenance activities to help stretch the dollars and potentially delay some big ticket items. The consultant is therefore a stakeholder in the development of a meaningful and useful report.

Myth 7: We are waiting to finish a big capital project (or investigation) before we get our report.

It is understandable that owners want the report to reflect all the positive work that has been done on their building. Some things to consider:

• A good depreciation report will recognize that a project is underway or is about to be launched. The data in the report can therefore be postdated to reflect this ongoing work.

• There is no harm in getting the process underway so that the owners can evaluate the proposals and award the contract.

• It takes a few months to complete the depreciation report, which should preferably be obtained prior to the end of the current fiscal year so that it can be used to make preparations for the next fiscal cycle.

Myth 8: It is too complicated and we don't know what to do.

By reading this article you are now hopefully in the process of educating yourself. The challenge, however, is to take the message back to the ownership at large and to educate the group so that they climb the learning curve. Here are some things to consider.

• There are lots of free consumer guides that are just a few clicks away on the internet.

• Ignorance is not bliss. At some point, the owners may find themselves in an awkward position of having to explain why due diligence was not done.

• The legislation requires the board directors, who have been elected by the owners to serve in the corporations' best interest, to act like prudent and reasonable people in comparable circumstances. While the Directors have errors and omissions liability insurance, who wants to have to defend such an embarrassing claim.

Myth 9: We passed a resolution at our last general meeting opting out.

While the owners, in their collective wisdom, may not want to take a long-range view of their building, it important to consider the following:

• The exemption lasts for only one year and must be updated at each annual general meeting.

• Continued exemptions will likely get harder over the ensuing years as more buildings complete their reports and the culture in the market changes.

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• Any building that is neglected will eventually take control of the owners.

Myth 10: There is no enforcement process so it can't be that important.

While it is true that the legislation has not (yet) set up enforcement procedures, here are some things to consider:

• Over the last few decades the legislation has gradually been tightened to steer the consumer towards responsible stewardship.

• The open market is serving as the enforcement police where the marketability of suites and resale value are compelling forces to contend with. Read the realtor blogs to get their perspective on the value of a depreciation report and how this impacts real estate buying decisions.

• Several thousand building have completed their studies and many studies are currently underway. Estimates are now at approximately 30-50% compliance and climbing.

I close with a powerful quotation that offers some food for thought for those owners who are still considering whether to obtain their report:

"The price of light is less than the cost of darkness" (Arthur C. Nielsen)

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