

CRP

*Certified
Reserve
Planner*

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**Reserve Fund Planning
Standards:
The Essential Elements**

**Defining the Scope and Substance
of a Reserve Fund Plan
As required by the CRP Committee
Real Estate Institute of Canada**

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Reserve Fund Planning Standards: The Essential Elements

CRP(E) (Certified Reserve Planner – Executive) is a professional designation initiated and advanced by The Real Estate Institute of Canada (REIC). CRP(E) members are professionals who have the education, expertise and experience of planning and managing reserve funds.

Preamble

Reserve fund planning and management has evolved over the past twenty (20) years in response to the requirements of condominium, non-profit and co-operative housing corporations to establish and maintain reserve funds for financing major repairs and replacements of common elements and assets.

The Condominium Act of Ontario mandates that condominium corporations establish one or more reserve funds and that they collect from the owners reserve fund contributions for funding future major repairs and replacements. While not specifically mandated, non-profit and co-operative housing must also set up reserve funds for financing major repairs and replacements.

In the governmental, institutional and private sectors, the need for reserve fund planning has been recognized, and proactive property administrators are increasingly using reserve funds for financing major repairs rather than funding such repairs out of cash flow.

Effective reserve fund planning and management is a fiduciary responsibility of condominium directors, and they must ensure that the reserve fund of their corporations are adequately funded. This requires that they adhere to acceptable reserve fund planning standards.

So far, reserve fund planning and management has been conducted at an ad hoc basis, and there are no recognized standards of reserve fund planning. Having created the CRP(E) designation, The Real Estate Institute of Canada has now assumed the leadership role of defining appropriate reserve fund planning and management standards.

Essential Elements

Comprehensive reserve fund planning and management must be based on basic principles, accurate information and statistical data, and circumspect analysis. A reserve fund plan must ensure adequate reserve funding for each reserve component.

The following are the essential elements of a sound reserve fund plan.

Purpose and Definition

The purpose of reserve planning and management is to focus on the function of the reserve plan and the significance of reserve fund management. Reference should be made to any legislation, regulations, policies or practices, which require compliance.

Reserve fund planning and management must be clearly defined in terms of objectives and outcomes of the reserve plan. The definition should include a statement as to the adequacy of the reserve fund.

Reserve Fund Standards

Effective planning and management of reserve funds require establishing standards, which define the scope and objectives of the reserve fund plan. Standards are unique benchmarks, against which reserve actions can be measured.

Reserve Fund Standards may be defined in terms of:

- Building ambience and classification
- Status or level of building maintenance
- Management policies and competence
- Consistency of performance

In reserve fund planning and management, standards must be established comprising the following aspects:

- Building or Property Standards
- Reserve Fund Planning Standards
- Reserve Fund Study Standards

Objectives and Outcomes

An effective reserve fund plan must contain clearly stated objectives and the desired outcomes, such as:

- Funding of all major repairs and replacements
- Adequate reserve requirements
- Adequate reserve funding

There are two sources of reserve funding or revenue:

1. Owners' contributions, and
2. Reserve fund investment income.

Every owner must pay his or her fair share toward reserves for repairs and replacements, and boards of directors or management must ensure adequate reserve funding, which is their fiduciary responsibility.

Reserve fund management, having the power of imposing reserve fund assessments, must assess reserve fund contributions in a fair and equitable manner; they must not over-assess nor under-assess.

Zero-Based Budgeting Approach

This requires an investigation and analysis of reserve fund fundamentals and essentials, based on reserve funding principles and priorities. The zero-based budgeting approach involves the following steps:

1. Reserve component requirement (i.e. roof)
2. Prioritization of reserve components
3. Description of reserve components
4. Quantification of reserve components
5. Quality determination of reserve components
6. Repair or replacement of reserve components
7. Estimating unit cost of reserve components
8. Total reserve component cost estimate
9. Observed condition or life cycle analysis
 - Normal life span, based on quality considerations
 - Effective age, based on observed condition
 - Remaining life span
10. Reserve fund requirements, based on life cycle analysis
11. Reserve component deficiency analysis
12. Reserve fund cash flow projections

Reserve Component Classification

A reserve fund component classification system should have two characteristics:

1. It should be uniform and universally accepted by the building and service industry throughout the country, and
2. It should be flexible enough to be expanded without changes to the existing number classification.

The most widely used building component classification is the Unifomat System, developed by the United States Government Services Administration, which has been adopted by the major cost estimating services and is based on the logical construction process:

- 1.0 Foundations
- 2.0 Substructure
- 3.0 Superstructure
- 4.0 Exterior Closure
- 5.0 Roofing
- 6.0 Interior Construction
- 7.0 Conveying
- 8.0 Mechanical
- 9.0 Electrical
- 10.0 Professional Services
- 11.0 Special Construction
- 12.0 Site Work

This classification system can be modified for reserve fund purposes, grouping building components into functional categories, as follows:

- 1. Building Structural and Architectural
- 2. Building Interior Finishes and Decorating
- 3. Building Mechanical Systems
- 4. Building Electrical Systems
- 5. Building Recreation Facilities
- 6. Site Improvement and Facilities

Component Cost and Condition Analysis

Each building component must be inspected, quantified and analyzed in terms of quality of construction and condition. A unit cost must then be estimated, which reasonably reflects the quality of the existing building component.

From the observed condition of each building component, life cycle estimates can be made in terms of normal life, effective age (observed condition) and remaining life.

Given these data observations and unit cost estimates, reserve fund component estimates can be prepared.

Economic Analysis

A reserve fund plan must be prepared in the context of current economic conditions and trends, because reserve fund funding projections and expenditures are predicated on prevailing inflation factors and interest rates.

Benchmark Analysis

A benchmark is a performance measurement, demonstrating what should be, not what really is. In reserve fund planning, it is imperative to know what the reserve fund criteria should be, based on current cost estimates and the current condition of the reserve components (life cycle analysis).

The benchmark analysis consists of the following calculations:

1. Current Component Replacement Costs

These are the estimated costs of major repairs and replacing reserve components at current prices.

2. Future Component Replacement Costs

These are the estimated costs of major repairs and replacing reserve components at future prices.

3. Current Reserve Fund Requirements

These are the reserve funds required today, considering the effective age of the reserve components.

4. Future Reserve Accumulations

These are the future reserves, having been invested at the projected interest rate over the relevant remaining life span.

5. Future Reserve Requirements

These are the unfunded future reserves, being the difference between future replacement costs and future reserve fund accumulations.

6. Annual Reserve Assessments (Contributions)

These are the annual contributions to the reserve fund, required to be paid into the reserve fund and to be invested for funding the future reserve requirements.

Financial Review and Analysis

This is a historic review and analysis of reserve fund operations, and it consists of examination of the financial statements from the beginning. This examination includes the following:

- Accounting principles and policies
- Reserve fund operations
- Review and analysis of reserve expenditures
- Critical analysis of reserve fund cash flows

The historic review will show a pattern of reserve fund cash flows and reserve component expenditures, which can be analyzed, yielding important information about the performance of reserve components. For example, if there have been numerous roof repair expenditures, it may be concluded that the roof should be replaced rather than continuing repairs.

Adequacy of Reserve Fund

The adequacy of a reserve fund can readily be measured by subtracting the benchmark reserve requirements from the actual reserve fund balance or reserve fund balances, as shown on the current financial statements.

There are two reserve fund measurements:

- Adequacy of the reserve fund position (balance), and
- Adequacy of reserve funding (contributions).

Reserve Fund Cash Flow Projections

Reserve fund cash flow projections are the culmination of an effective reserve fund plan, presented in a format consistent with the statement of reserve fund operations in the financial statements. The basic format consists of:

Reserve Fund Opening Balance

Reserve Fund Contributions
Reserve Fund Investment Income

Reserve Fund Cash Resources

Reserve Fund Expenditures

Reserve Fund Closing Balance

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The CRP and CRP(E) identify those with the knowledge, skills and experience in reserve planning.

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CPM®	CERTIFIED PROPERTY MANAGER®
CLO	Certified Leasing Officer
CRF	Certified in Real Estate Finance
CRES	Certified Real Estate Specialist
CRU	Certified Residential Underwriter
CRP	Certified Reserve Planner
CRP(E)	Certified Reserve Planner (Executive)
ARM®	ACCREDITED RESIDENTIAL MANAGER®

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