CAPITAL PROJECTS: DECIDING WHICH PROJECTS TO UNDERTAKE AND HOW TO PAY FOR THEM

Capital projects are large- and small-scale projects outside the scope of regular upkeep and maintenance. Costs related to regular upkeep and maintenance are paid from the operating budget. Capital projects are paid from the capital plan budget. At Pacifica, most capital projects are determined from the depreciation report and planned as far in advance as possible, but sometimes projects arise because of an unexpected problem or need.

Deciding Which Projects to Undertake

Each year, the Strata Council reviews the current state of capital assets and the depreciation report to determine which projects should be undertaken. Because the depreciation report provides an estimated lifespan of the strata's assets, the Strata Council must decide whether and when a specific asset needs to be upgraded or repaired. Some assets may need to be replaced before the end of their anticipated lifespan if they are aging prematurely, while others may last longer than expected. The Strata Council decides which projects to undertake in consultation with the Property Manager, Facilities Manager(s), Consulting Engineers, and companies whose expertise lies in the relevant area.

The Strata Council strives to balance being proactive (i.e., replacing an asset before it fails) with being responsive (i.e., replacing an asset after it has failed). Sometimes, it is reasonable to let an asset fail before replacing it; sometimes it is not because it may be costlier or compromise safety. Sometimes, it is obvious that a project needs to be undertaken, and sometimes it may not appear obvious. The Strata Council aims to determine when sufficient consultation has occurred and information has been gathered before making a decision.

Paying for Capital Projects

Capital projects may be funded from a combination of sources:

- The contingency reserve fund (CRF)
- Special assessments
- Borrowing against strata-owned assets

Not everyone is going to agree on which method to use. The pros and cons of each are discussed in more detail below.

Contingency Reserve Fund (CRF)

Each year, owners contribute to the contingency reserve fund (CRF) through their monthly fees. The CRF is used to fund projects outside the scope of regular upkeep and maintenance. The provincial Strata Property Act dictates how much stratas must contribute (at a minimum) to their CRF and how the money may be used. Owners may contribute to the CRF to fund projects that may not occur until years from now or they may treat it as a rainy-day or emergency fund. If a major repair must be addressed immediately, the money in the CRF can be used to start the repair.

Some stratas choose to fund all their capital projects from their CRF. The advantage with this method is that there is, usually, always money for projects; special assessments are rarely needed. The disadvantage is that monthly strata fees are considerably higher because the fund always needs to be replenished.

Pros of using CRF to fund capital projects:

- Owners don't have to worry about unexpected or fluctuating special assessments.
- Owners who don't like or struggle with saving for special assessments don't have to do so: funding the CRF is part of the owner's monthly strata fees.
- Potential buyers may be attracted by the idea that future capital projects are already partially funded.

Cons of using CRF to fund capital projects:

- Monthly strata fees are much higher.
- Potential buyers may be discouraged by high strata fees, as the CRF needs to be constantly replenished.
- Current owners may be reluctant to fund long-term capital projects in advance this way, from which future owners are expected to derive benefit.

<u>Special Assessments</u>

A special assessment, or special levy, is money collected from owners in a lump sum for a specific purpose (e.g., replacing a roof). Pacifica generally pays for capital projects through special assessments.

Pros of using special assessments to fund capital projects:

- Owners maintain control of their money until the strata needs it.
- Monthly strata fees are lower.
- Potential buyers are attracted to lower strata fees.

Cons of using special assessments to fund capital projects:

- Owners may be frustrated by unexpected or fluctuating special assessments that differ from year to year, making budgeting challenging.
- Potential buyers may be concerned that there are not sufficient funds in the CRF for required capital projects, which can make resale more challenging or purchase price negotiations more complicated.

<u>Borrowing Against Strata-Owned Assets</u>

Another way of paying for capital projects is by borrowing the money. Pacifica could borrow money or mortgage the strata-owned Facilities Manager's suite and use that money to pay a special assessment. The strata-owned suite had a mortgage in the past; this mortgage was to facilitate purchasing the suite from the developer. The owners voted and agreed to pay off the remaining mortgage balance as a lump sum in 2015.

The problem with borrowing or mortgaging the suite is that it may force some owners to pay more for a capital project than they wanted to. For example, Owner A may have saved and has cash on hand for a special levy, but Owner B does not have the cash. By borrowing, Owner A is forced to pay interest on a loan when they could have just paid their share with the cash they already had on hand. Owner A pays more when Owner B had the option of increasing their own personal mortgage or getting a home equity loan to pay the special levy.

Pros of borrowing to fund capital projects:

- A one-time reduction to a special assessment required from each owner.
- An immediate cash injection is not required from owners, as borrowing amortizes the capital project costs over a longer period.

Cons of borrowing to fund capital projects:

- Monthly strata fees increase as the loan principal and interest payments are added to the operating budget.
- All owners must participate in borrowing and paying interest when some may not have wanted or needed to.
- Risk of frequent increases in monthly strata fees, as interest rates fluctuate.
- Potential buyers may be discouraged due to higher strata fees.

<u>More Information</u>

PQ Online

The PQ Online website has Pacifica's latest Depreciation Report from 2019, which provides projected expenditures for the next 30 years. Owners are urged to factor the expenditures into their own financial planning. If you do not already have access to PQ Online, please contact Michael Henson, Property Manager (mhenson@pacificquorum.com) for a username and password. To log into PQ Online, go to: https://pacificquorum.com/online-services/pq-online-login/

Province of BC

The Province of BC website has a lot of resources and information about stratas. For more information about repairs and maintenance, go to: www.gov.bc.ca and search for "strata repairs and maintenance."

Condominium Home Owners Association of BC (CHOA)

The CHOA website offers several resources that are available to the public: www.choa.bc.ca