Condominium Home Owners' Association of British Columbia
Leadership, Education and Resources for strata owners across BC
Website: www.choa.bc.ca / Toll-free: 1.877.353.2462
Bulletin: 400-007 (Updated September 1, 2017)

What you need to know: Depreciation Reports

What is a depreciation report?

A depreciation report identifies the common property, common assets and those parts of a strata lot the strata corporation by bylaw must repair and maintenance. The depreciation report will determine:

1) What assets a strata corporation owns (an inventory)
2) The assets conditions (evaluation)
3) When items need to be replaced (the anticipated maintenance, repair and replacement)
4) How much money the strata corporation currently has (contingency reserve report)
5) What it is likely to cost for future replacement (a description of the factors and assumptions in projecting costs)
6) How the strata corporation can pay for the costs (three cash-flow funding models projecting 30 year replacement periods)

Strata corporations in British Columbia are required under the *Strata Property Act* (SPA) to obtain a depreciation report. The Strata Property Regulations provide the framework for the information required in the report, the requirement that the physical component inventory and evaluation be based on an on-site visual inspection, financial forecasting that must include at least three cash-flow funding models, the definition of who is qualified to provide the report, and timing requirements for the report.

Strata corporations with fewer than 5 strata lots are exempt from the requirement to obtain a depreciation report.

Strata corporations may waive the requirement to obtain a depreciation report by annually passing a 3/4 vote resolution. However, being exempt or waiving the requirement for a depreciation report does not discharge the strata corporation from the obligation to repair and maintain common property and common assets as required by the SPA.

If the strata corporation fails to approve a 3/4 vote resolution the strata corporation has six months to comply with the legislation and have a depreciation report completed.

What steps can a strata corporation take before they hire a qualified person to obtain a depreciation report?

To save costs and coordinate an efficient and accurate depreciation report a strata corporation may want to gather all of its records and documents, including following:

- Name and contact information for the strata corporation's depreciation report contact person
- Name and contact information for the strata corporation's treasurer
- Annual operating budget
- Current balance sheet, including the contingency reserve fund (CRF) balance and any investments & assets
- List of future expenditures to be made to CRF that have been approved but not spent
- Description of common problems
- Copies of invoices relevant to operations, repairs and maintenance
- Current insurance certificates and insurance appraisals
- Any reciprocal easements/Service Agreements/Air Parcel Agreements
- Any leases and licenses (enter phone systems, parking garage use, etc.)
- Any agreements granting third party use and access of the strata property

- Prints, plans and drawings – architectural, structural, mechanical, electrical, fire protection and other systems
- Any previous investigation reports: maintenance, repair, building envelope condition assessment, etc.
- Annual fire inspection report
- Maintenance contracts, logs and manuals for mechanical, electrical, elevator, building, etc.
- History of repairs and replacement of common property
- Registered strata plan & any amendments
- Registered bylaws & any amendments, including bylaws where the strata corporation has taken responsibility for the maintenance and repair of part of a strata lot
- Any information & bylaws relating to sections
- Any registered allocations of limited common property (LCP)
- Any alteration agreements where an owner has taken responsibility for the cost of the maintenance or renewal of an alteration to a strata lot, common property or common assets
- Lawsuits or arbitration decisions that impact property use, requiring the maintenance and repair of certain assets
- Copy of any previous depreciation report

In the absence of some documents, the qualified person preparing the depreciation report will need to make some reasonable assumptions. For smaller strata corporations your document requirements may be limited; however, at a minimum, your depreciation report planner will need a copy of the registered strata plan, all registered bylaws and any condition assessment reports will be important for the initial stages of the proposals and planning.

To simplify the depreciation report process, and to assist with accurate long-term archiving of documents, it is recommended documents, including the large scale drawings, be scanned into electronic format if possible to use when preparing the depreciation report.

Who is a “qualified person” to develop a depreciation report?

Strata Property Regulation (Regulation) 6.2(6) broadly defines who is qualified to develop your depreciation report. *A* ***“qualified person”*** means any person who has the knowledge and expertise to understand the individual components, scope and complexity of the strata corporation’s common property and common assets. Including those parts of a strata lot or limited common property, or both, that the strata corporation is responsible to maintain or repair under SPA, the strata corporation’s bylaws or an agreement with an owner. The qualified person must prepare a depreciation report that complies with section 6.2(1) to (4), of the Regulation.

Hiring a qualified person is important as various third parties will be relying on the information contained in the report.

Depreciation reports provide strata corporations with a legislated planning tool for renewals, maintenance and financial planning. The report may become a significant document in assessing property asset value and must be disclosed with the Information Certificate (Form B). It is important to note that the strata corporation must retain a copy of the depreciation report under section 35 and make it available if requested at any time under section 36 of the SPA.

The report may be used by insurance providers, mortgage providers, mortgage insurers, and most of all, buyers. This is an official report, and may be used to determine a buyer’s qualification’s for a mortgage, to establish risk for insurers, and for buyers to determine their future liabilities before they decide to purchase a strata lot. Throughout all of these transactions third parties are relying upon the information in the depreciation report which could result in potential liability for the strata corporation with respect to the accuracy and reliability of information in the report.

What is the duty of the qualified person preparing the report?

The person preparing the report must disclose in the report their qualifications, their relationship with the strata corporation and whether or not they carry errors and omissions insurance, as well as a description of that insurance. Their qualifications have a direct link to their duties under the regulations. The qualified person will be required to:

- Provide an inventory of the strata corporation's common property, common assets, and any limited common property or part of a strata lot that the strata corporation has a duty to maintain, repair and renew.
- Provide an evaluation of the inventory by performing a physical review of the site and the components.
- Provide an evaluation that addresses the following requirements:
    - Estimate the service life of the assets over the next 30 years,
    - The anticipated maintenance, repair and replacement costs that usually occur less than once per year,
    - Evaluation of the components (the current condition),
    - Financial evaluation of the factors and assumptions used in estimating the costs over the 30 year period,
    - A description of how the CRF is currently being funded, along with a current balance, minus any expenditures that have been approved but not yet taken from the fund, and
    - At least three cash-flow funding models for the CRF relating to the maintenance, repair and replacement over 30 years.

What skills will be necessary for the person / team / company providing the report?

- The ability to read and interpret technical documents and drawings.
- The education, experience and knowledge to be able to conduct on-site inspections of building components and provide a reliable assessment of their condition and remaining life expectancy.
- A knowledge of building systems, building codes, plus an understanding of material defects, product compatibility, product availability and new technologies.
- An understanding of the structure and governance of strata corporations and their legislated obligations for maintenance, repair and replacement of components.
- An understanding of the application of strata corporations that have duly constituted sections, air parcel agreements, and multiple strata corporations that share joint facilities.
- An understanding of the financial obligations of strata corporations for annual budgets, CRF and special levies.
- The ability to financially project and prepare at least three different cash-flow funding models over 30 years.

Who do you hire to prepare a depreciation report?

The following professions may have the skills and qualifications necessary to prepare a depreciation report:

- A person who is a registered professional engineer with the Association of Professional Engineers and Geoscientists of B.C.,
- A person who holds a certificate of practice within the meaning of the Architects Act of B.C.,
- A person who is a member of the Real Estate Institute of Canada and holds the designation of a Certified Reserve Planner (CRP),
- A person who is a member of the Appraisal Institute of Canada,
- A person who is a member of the Canadian Institute of Quantity Surveyors and holds the designation of professional quantity surveyor, and
- Other persons who meet the qualifications and skills required by the Regulations.

Preparing a depreciation report requires technical, financial planning, and management skills. This type of expertise may be difficult to find in one individual. Depending on how complicated and extensive your strata corporation is, this may mean your depreciation report is prepared by a team of professionals rather than an individual. As part of finding the right person to conduct the depreciation report for your strata corporation, it is recommended that a strata corporation:

- review the experience of the person/company,
- obtain references,
- determine the ability to provide errors and omission insurance,
- review samples of past reports completed,
- request a copy of their professional liability insurance to verify current status and coverage, and
- any other relevant documentation that attests to the knowledge and competency of the person/company.

How long will it take to complete a depreciation report?

The size, age, availability of documentation and the complexity of the common assets and common property of the strata corporation will have a direct impact on how long it will take for a depreciation report to be completed. However, it is important that the strata corporation negotiate the time frame for completion before work begins and ensure protocols are in place if the time frame needs to be adjusted. For example, who to contact (council member or strata manager) and how (by email or phone call).

What things should a strata corporation consider prior to engaging a depreciation report planner?

Before a strata corporation engages a depreciation report planner it is important that the strata corporation ask and understand the answers to the following questions:

- How will the final report be delivered to the strata corporation (electronically, paper format, both)?
- Will the depreciation report planner attend an information session with owners to explain the report? Will this cost extra?
- If the strata council determines changes are required to the depreciation report, how are changes to be addressed?
- How long will it take to get changes back from the depreciation report planner? How much time does the strata corporation have to request changes be made? For example, the strata corporation may only have 1-2 months to review the report and request changes or they may be charged an additional fee to incorporate the changes.
- Get the service agreement in writing.

Do the Regulations permit a strata corporation to conduct their own depreciation report?

The regulations do not prohibit a strata corporation from preparing their own depreciation report. However, a strata corporation must consider the requirements of SPA and the Regulations and any possible liabilities before conducting a depreciation report without a qualified person. A person (when applied also means the consulting company or group of certified professionals who make the proposal) is going to be identified as providing the report. If the strata corporation provides their own report, then it must be disclosed in the report that the information has been provided by the strata corporation, and/or specific individuals. The report must also disclose who the person(s) is, the liability, qualifications and competency of that person.

Remember that the depreciation report imposes a level of liability on the strata corporation for accuracy as it is relied on by insurance providers, mortgage providers and mortgage insurers, and most of all, buyers. This is an official report. It may be used to determine a buyer’s qualification’s for a mortgage, to establish risk for insurers, and for buyers to determine their future liabilities before they decide to purchase a strata lot. Throughout all of these transactions, the strata corporation is exposed to liability.

If a strata corporation prepares their own report, how does a strata corporation manage the liabilities of possible inaccurate information or errors in reporting information?

Ultimately, the strata corporation and the person(s) in the strata corporation who prepare the depreciation report are left with the complete scope of liability and no recourse against a third party. If there is an error, resulting in an action for damages against the strata corporation, does the strata corporation have any coverage under the directors and officers' liability insurance with respect to having provided this service? Every insurance policy has unique terms, conditions and exclusions. It is strongly suggested that before a strata corporation ventures into creating and providing a depreciation report, they contact their insurance broker to determine the extent of coverage, if any, under these conditions.

Who makes the decision to provide your own report?

Before a strata corporations proceeds with preparing their own depreciation report, it needs to consider if this has been a decision of the strata council or the owners at an annual or special general meeting. Are the owners aware that they are assuming liabilities before they make this decision? Remember the SPA requires council members to exercise the care, diligence and skill of a reasonably prudent person in comparable circumstances. However, these conditions are not likely that of a volunteer given the conditions set out by the regulations.

Can a strata corporation be exempt from the need for a depreciation report and what are the implications of such a decision?

Strata corporations of five or more units are required to obtain a depreciation report. However, a strata corporation of five or more units may waive the requirement, if the strata corporation annually passes a 3/4 vote at an annual or special general meeting. This will require the strata corporation to include the exact wording of the 3/4 vote resolution with the notice package of the general meeting and include it on the agenda. The strata corporation minutes will then reflect the results of the 3/4 vote.

However, before a strata corporation considers waiving this requirement, consider the implications. Depreciation reports are going to be a widely used tool to manage risk for buyers purchasing in a strata corporation. A buyer and their mortgage provider or mortgage insurer may have a keen interest in a depreciation report. Therefore, the absence of a report may make it more difficult for an owner to sell their strata lot as financial institutions may be reluctant to lend if possible special levies and other future costs are unknown. Also, buyers will be using depreciation reports to determine the accuracy of the asking price. The absence of a depreciation report may impose restrictions on the property that may limit the ability of an owner to sell their strata lot.

What happens if a strata corporation fails to pass a 3/4 vote to waive the requirement to obtain a depreciation report?

If a vote to waive the requirement to obtain a depreciation report fails, the strata corporation has six months to complete a depreciation report. Generally, strata corporations will vote to waive the requirement for a depreciation report at an annual general meeting and every annual general meeting thereafter.

What time lines apply to depreciation reports?

Strata corporations must renew their depreciation report every three years. However, the strata corporation could alternatively waive the requirement to renew their depreciation report.
Strata corporations that have waived the requirement to obtain a depreciation report, by a ¾ vote, must obtain a depreciation within 18 months from the date the resolution was passed. The 18 month timeframe allows six months to complete a depreciation report if an exemption passes one year but fails at the next annual general meeting or special general meeting. Remember that strata corporations may continue to waive this requirement with an annual ¾ vote of the owners at an annual or special general meeting.

Strata corporations are reminded that they must include a copy of the latest depreciation report with the Form B. If the strata corporation passes a ¾ vote resolution to waive the requirement to renew a depreciation report the strata corporation will need to provide the old depreciation report with the Form B which may be outdated and inaccurate.

Strata corporations that are formed after December 14, 2011, are required to obtain a depreciation report within 6 months after their second annual general meeting.

How often does the depreciation report need to be renewed?

The SP regulations require the depreciation report be renewed obtained every three years. Subsequent reports may be less expensive than the original baseline report as most of the information and modeling will only require updating. However, the renewed report must still include on-site visual inspections and cover at least 30 years from the current date. Be aware that, in addition to your assets having aged since the last report, interest rates, inflation rates, and the cost of items and labour will likely have changed.

Some experts advise that depreciation reports should cover the entire expected life of the building rather than the minimum 30 years required. Such a report may be no more expensive and would give the strata corporation better information to use in planning, saving and equitably allocating costs between present and future owners.

How do we pay for a depreciation report?

A strata corporation may pay for a depreciation report as an operating expense, by an expenditure made from the CRF or by a special levy. Recent legislative changes to section 92 of the SPA clarify that paying for and accruing funds to pay for a depreciation report is now an operating fund expense. This expense may now be included in the annual budget therefore is approved by a majority vote or section 96 now allows strata corporations by a majority vote to approve spending money from the CRF in order to obtain a depreciation report or pay for repairs specifically recommended by a depreciation report.

If we are in the process of completing our depreciation report, what information do we include with the Form B?

Section 59 of the SPA requires the Form B Information Certificate disclose specific information about the strata corporation and the strata lot. Form B's are completed by the strata corporation or strata manager.

Once the strata corporation has received a depreciation report, it must attach the complete report to the Form B. A summary of the report does not satisfy the requirements of the SPA.

Is the initial report received by the strata corporation a "draft report" until all owners approve the report?

The SPA and the Regulations do not refer to or use the term draft report in the legislation. Therefore, when a report is received it is subject to the disclosure requirements of SPA sec 35 and 36. The legislation does not require the owners to approve the report. Ultimately, it is the strata council that reviews the report. The strata council may request changes if inaccuracies are found.

What should council do with the depreciation report once it is received?

Once the report is received by council, it is up to council to review it carefully for accuracy and interpretation of the strata plan and bylaws. It is important to note that the depreciation report is not required to be approved by the owners. Check that your reports includes:

- includes a summary of the report (this can be included with the annual budget reports to help owners understand the funding requirements)
- discloses the qualifications of the depreciation report planner/team/company
- identifies the relationship between the depreciation report planner and the strata corporation
- discloses if the depreciation report planner has errors and omissions insurance and a description of that insurance

- includes a complete inventory of all the strata corporation's common assets, common property and any limited common property or part of a strata lot that the strata corporation has a duty to maintain, repair or renew
- provides an evaluation of the inventory
- estimates the service life of the common property and common assets over the next 30 years
- includes a description of how the CRF is currently being funded, along with the current balance, minus any expenditures that have been approved but not yet taken from the fund
- includes at least 3 cash-flow funding models for the CRF relating to the maintenance, repair and replacement of common property and common assets over 30 years
- details financial evaluation factors and assumptions used in estimating the cost over the next 30 years

The depreciation report will give the strata corporation a clear picture on what is required financially and operationally in the coming years to maintain the strata corporation. The depreciation report will help strata corporations plan for annual and long term repairs, maintenance and renewals. It will also disclose the financial obligations required now and in the future. However, it is up to the owners of the strata corporation to decide annually on funding and operations.

It is important that owners are provided a copy of the report and that the depreciation planner deliver the report to owners at an information meeting. This will ensure that owners are well equipped to make better informed financial and operational decisions. It is suggested that the depreciation report be incorporated into the strata council operating manual and be attached to annual notice packages for each annual general meeting.

What if the strata council does not agree with what the depreciation report provides?

Once the depreciation report is received, even if the council does not agree with the depreciation report, it forms part of the strata corporation's records. It must be attached to any Form B Information Certificates or any request from an owner until the time an updated depreciation report is completed.

What if the owners do not agree with the three cash-flow funding models provided in the depreciation report?

The cash-flow funding models are just examples. A strata corporation may consider other formulas. The purpose of the three cash-flow funding models is to assist strata corporations in understanding the impact of different levels of funding on reserves and how they will apply to the frequency of future special levies. The decision on funding is up to the strata corporation each year as part of the approval of its annual budget.

It is much easier for the owners to approve an expense from the contingency reserve fund than to have to pay for large special levies. Therefore, it is important for a strata corporation to begin funding the depreciation report as it will take a combination of increased long term funding and some special levies to ensure the strata corporation is fully funded.

Remember that strata corporations approve operating expenses on an annual basis as part of the annual budget approval process. Therefore, this is the perfect time for strata corporations to discuss maintenance and renewals and make adjustments to funding as decided by the majority of the owners.

Is there a limit on how much money we can contribute to the contingency reserve fund?

No, there is no limit how much money can be contributed to the CRF. Strata corporations control their long term planning by addressing CRF contributions as part of their annual budget. Given that it is part of the annual budget a majority vote of the owners at the annual general meeting will determine the contribution amount for that fiscal year. Strata corporations may use a funding model provided in the depreciation report or consider an alternative funding model to bring their contingency reserve levels up to an appropriate level for their strata corporation. Planning for the financial future of the strata corporation will include investing appropriately to ensure that amortization of funds at least equals inflation rates. For more information on investing please refer to CHOA's investing guide.

How do we pay for repairs or renewals recommended in a deprecation report?

The way that strata corporations pay for repairs and renewals has not changed; they may either raise funds through operating expenses, a special levy or use funds from the CRF. What has changed is that the legislation now only requires a majority vote of the owners to spend CRF if the depreciation report recommended the renewal or maintenance.

However, a strata corporation may only take advantage of the majority vote if the CRF has enough money to fund the renewal or maintenance requirement and is approved by a majority vote resolution at a general meeting.

For this reason it is recommended strata corporations proactively contribute to CRF. It is easier to pass a majority vote to draw funds from the CRF versus a ¾ vote to approve a special levy and will incur less hardship on the owners and reduce the pressure and cost on a strata corporation to collect unpaid special levies.

If your strata corporation is proactively saving please refer to CHOA's investment guide for information on how funds may be invested.

What information needs to be in the resolution to spend funds from the contingency reserve fund?

If the strata corporation is spending funds from the CRF by a majority vote it is strongly suggested that the resolution be detailed enough to ensure the strata council has the authority to spend the funds and enter into the required contracts. In addition, it may be important for the strata to seek legal advice on the resolution. An example of a resolution to approve a CRF expenditure is as follows:

<u>SAMPLE – Resolution to Approve CRF Roof Expense</u>
The Owners, strata plan ABC1234, by majority vote, hereby authorize an expense of up to $(amount) for the renewal of the (blank roof area) as recommended in the current depreciation report. Include:

- description of project;
- consulting such as inspection, engineering, and legal services;
- detail complete scope of services for all work authorize
- estimates to approve the amount required for completion.
- time frame for the projection completion

If your strata corporation requires a special levy under section 108, consult a lawyer in the writing of the resolution to confirm the resolution complies with the Act & Regulations.