

What you need to know: Investing your Contingency Reserve Fund or Special Levy

The *Strata Property Act* (SPA) permits a strata corporation to invest its contingency reserve fund (CRF) and special levies in insured accounts with savings institutions in British Columbia, plus those permitted by the regulations.

As of July 16, 2014, Strata Property Regulation 6.11 was amended to streamline the types of investments that strata corporations may invest in, such as treasury bills, bonds and fixed income exchange traded funds. The amendments eliminated rarely used and riskier investments, such as individual stocks or preferred shares. The intent of the amendment is to ensure that strata corporations invest in secure, insured

investments. Insured investments are deposits or certificates insured by the Canadian Deposit Insurance Corporation or the Credit Union Deposit Insurance Corporation of British Columbia.

Many strata corporations already invest in instruments that qualify under the new regulation. However, in the rare situation that a strata corporation has an existing investment that does not comply with the amended regulation, the investment is grandfathered until it matures or is sold. The amended regulation is as follows:

Permitted investments for money held in contingency reserve fund and collected on special levies

6.11 In addition to an investment permitted under the Act, for the purposes of section 95 (2) (a) or 108 (4) (b) (i) of the Act, as applicable, a strata corporation may invest money held in the contingency reserve fund or money collected on a special levy in one or more of the following investments:

- (a) a savings account or chequing account with a financial institution outside of British Columbia insured by the Canada Deposit Insurance Corporation;
- (b) a term deposit or a guaranteed investment certificate, if the deposit or certificate
 - (i) is insured by the Canada Deposit Insurance Corporation or the Credit Union Deposit Insurance Corporation of British Columbia, and
 - (ii) has a predetermined rate or predetermined rates of interest;
- (c) a treasury bill issued by the government of Canada;
- (d) any bond, debenture or other evidence of indebtedness issued or guaranteed by the government of Canada or a province, or issued by a corporation incorporated under the laws of Canada or a province, if, at the time of purchase,
 - (i) the bond, debenture or other evidence of indebtedness has a remaining term to maturity of 5 years or less,
 - (ii) the interest and principal of the bond, debenture or other evidence of indebtedness are payable in Canadian dollars, and
 - (iii) the bond, debenture or other evidence of indebtedness has a rating of A or higher from DBRS Limited;
- (e) a fixed income exchange-traded fund traded on an exchange in Canada, if, at the time of purchase,
 - (i) the fund's portfolio does not contain securities other than bonds, debentures and other evidence of indebtedness,
 - (ii) the holdings in the fund portfolio are denominated in Canadian dollars,
 - (iii) the average remaining term to maturity of the holdings in the fund's portfolio is 5 years or less, and
 - (iv) 98% or more of the value of the holdings in the fund's portfolio have a rating of BBB or higher as reported by the issuer of that fund.

Descriptions of types of investments permitted

The following definitions explain the various types of investments permitted by a strata corporation:

Savings account or chequing account – an account maintained by a financial institution in British Columbia or outside of British Columbia, if the financial institution is insured by the Canadian Deposit Insurance Corporation, which pays interest and is generally accessible as needed.

Term deposit - is a deposit held at a financial institution that has a fixed term with a predetermined rate of interest. These are generally short-term with maturities ranging anywhere from a month to a few years. When a term deposit is purchased, the strata must understand that the money can only be withdrawn after the term has ended or by giving a predetermined number of days' notice. In addition, the regulation requires the deposit be insured by the Canadian Deposit Insurance Corporation or the Credit Union Deposit Insurance Corporation of British Columbia.

Guaranteed investment certificate (GIC) – provides a guaranteed rate of return over a fixed period of time. The investment earns interest at a predetermined rate or predetermined rates of interest. Most are non-redeemable prior to maturity however, there are some exceptions. A GIC term usually ranges from 1 to 5 years. Similar to the term deposit, a GIC must be insured by the Canadian Deposit Insurance Corporation or the Credit Union Deposit Insurance Corporation of British Columbia.

Treasury bill -These are commonly called T-Bills and are short term investments. The regulation only permits a T-Bill issued by the federal government of Canada. T-Bills are sold at a discount price and mature at par. The difference between the cost and maturity value represents the purchaser's income instead of interest. T-Bills can typically be purchased with terms of 30 days, 60 days, 90 days, six months and one year.

Bond or debenture – A bond is a debt instrument and when a strata corporation purchases a bond it becomes a creditor to the bond issuer. The bond issuer may only be the federal or provincial government or a corporation incorporated under the laws of Canada or a province. In exchange for the investment (or loan), the bond issuer promises to pay you a certain amount of interest for a specified length of time, and to repay your principal investment amount at the bond's maturity.

The terms “bonds” and “debentures” are often used interchangeably. However, unlike a bond, no assets are pledged against a debenture. Indebtedness of a government or corporation that is backed strictly by the general credit of the issuer.

Fixed income exchange-traded fund - is an investment fund traded on an exchange in Canada. The fund's portfolio holds a range of bonds, debentures and other evidence of indebtedness that track a specific market index, sector group or investment type, for example the bond index. Generally, the fund trades close to its net asset value over the course of the trading day.

It is strongly recommended that strata corporations carefully review the terms and conditions of all investments with a financial advisor or financial institution as there may be administration fees and penalties that the strata corporation must be aware of prior to agreeing to an investment.

What money can be invested?

A strata corporation may invest their CRF and special levies. Contributions to the CRF are determined annually as part of the budget approval process at the annual general meeting. CRF expenditures are generally common expenses that usually occur less than once a year or are unexpected, such as major or capital repairs and emergencies. A special levy is money raised by the owners for any purpose established by a $\frac{3}{4}$ vote resolution passed by the strata

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corporation at an annual or special general meeting.

Why invest?

Strata corporations invest their funds with the expectation of growing their money. It is important to note that all investments are different, some charge an investment fee, some are locked in for specific time frames and others may offer a higher rate of return but are riskier. Investments are a matter of preference, there are is not a one size fits all solution. If the strata corporation is

considering investments other than secure term deposits or guaranteed investment certificate (GIC) it is strongly recommended that the strata corporation seek independent legal and investment advice. Strata managers are not licensed to provide investment advice, therefore do not seek investment advice from a strata manager.

Below is an example of the potential income that could be earned if a strata corporation invests funds over a 10 year period.

Amount Invested	Final value (2% return)	Final value (3% return)	Final value (4%)
\$10,000 per year over 10-years	\$109,486.73	\$114,627.24	\$120,048.34
\$50,000 per year over 10-years	\$608,435.77	\$640,389.78	\$674,317.57
\$100,000 per year over 10-years	\$1,216,871.54	\$1,280,779.57	\$1,348,635.14

*Calculations provided by Bank of Montreal

Who decides how investments are made?

How investments are made, where the funds are held and the term of investments are the decision of the strata council. All council decisions are made by a majority vote and are to be recorded in the council minutes. The minutes are important as they provide notice to owners how their money will be invested and it provides the authority for the strata manager or an authorized council member to make the investment. In addition, it is suggested that copies of the investment certificates or instruments be provided as an attachment to the council meeting minutes following the investment taking place. Transparent disclosure ensures owners are kept well informed as to where the strata corporation money has been invested.

Strata council must also be prudent in when and how much money they invest. It does not make sense to invest all funds just in case an unexpected expenditure, such as an emergency repair or insurance deductible, occurs and the strata corporation does not have sufficient cash to cover the expense.

In order for your strata manager to have the authority to invest and transfer strata corporation funds, the strata council must make the decisions and give instructions to the manager. The instructions may be given by way of strata council minutes, contractual obligations, or an email or memo from the strata council.

Also, the decisions of council to invest the fund are subject to any resolutions passed by the owners at an annual or special general meeting or as stipulated in the bylaws of the strata corporation. For example, that the strata council must only invest the special levy fund in a GIC with a specific financial institution. It is important to remember that owners may by a majority vote direct the strata council in its exercise of powers and performance of duties.

Whose name must be on the investment?

Investments must always be placed in trust and accounted for separately. It is recommended that investments be "in trust for the owners, strata plan _____", and that the strata corporation consults with a qualified official with a financial

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institution governed under the *Bank of Canada Act* or the Financial Institutions Commission of British Columbia.

The SPA requires a strata corporation to account for the money collected for a special levy separately from other money of the strata corporation. Therefore, CRF and special levy investments must not be co-mingled funds.

How can interest earned on the investment be used?

Section 95 of the SPA requires that any interest or income earned on the money in the CRF must become part of the fund and be reported as part of the strata corporation revenue. It must not be used for any other purpose.

If money collected for a special levy, including interest or income earned on that money, exceeds the amount required for the resolution and no owner is entitled to receive a refund from

contributions made then the strata corporation may deposit the excess in the CRF.

How to report investment fees?

If a strata corporation is paying an investment fee to manage the investment instrument the fee must be shown as a separate expense item on the annual financial report. In addition, the fee must be either approved in the annual budget or by a ¾ vote of the owners at an annual or special general meeting.

What terms are appropriate?

Strata council needs to be cautious when determining the appropriate term for each investment. Terms will depend on when the strata corporation requires access to the funds. For example, if the strata corporation decides to replace its roof in eighteen months it would be prudent not to lock in funds for three years.

Below are a few examples of products and terms offered by the Bank of Montreal.

PRODUCT (as of August 18,2014)	RATE	ANNUAL INCOME BASED ON \$250,000 INVESTMENT
Variable Rate GIC	1.05%	\$2,625
1-Year Traditional GIC	1.40%	\$3,500
2-Year Traditional GIC	1.60%	\$4,000
3-Year Traditional GIC	2.00%	\$5,000
4-Year Traditional GIC	2.10%	\$5,250
5-Year Traditional GIC	2.35%	\$5,875
BMO Canadian Market GIC*	6.00%	\$15,000
BMO Top Performing Portfolio GIC*	5.00%	\$12,500
Rate Optimizer Plus GIC	2.30%	\$5,750

*A Market GIC or Portfolio GIC may be a product recommended by your financial institution. These types of GICs are generally not compliant with the Regulation unless the principal is guaranteed and there is a predetermined rate of interest.

How does a depreciation report impact investment decisions?

As strata corporations embrace the value of obtaining a depreciation report there will be a significant rise in reserve funds being collected

and held by strata corporations. These reserve funds will in turn generate a substantial amount of interest which needs to be considered by the professionals completing the three funding models presented in the depreciation report.

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The safe management and disclosure of strata trust funds is critical for all strata corporations. Given the possible increase in funds being collected by strata corporations, strata councils need to pay more attention to protecting their assets. It is prudent for a strata corporation to implement processes for fraud prevention. This would include items like ensuring signing authority is properly delegated, separate accounts for all funds, reimbursements and replenishing petty cash only with approved receipts.

If a strata manager holds the funds for a strata corporation the money must be held in a separate trust account in the name of the strata corporation: "In trust for the owners, strata plan _____". The location of the funds must be disclosed and the strata manager must provide the strata corporation with the actual monthly bank and investment statements of those accounts. It is imperative that those balances and expenses be scrutinized and cross referenced by the treasurer of the strata corporation and approved by the strata council as part of the financial review process. If the information is not being disclosed as required by *Real Estate Services Act*, Regulations and Rules of the Real Estate Council of British Columbia, there may be a serious problem. It is important to remember that trust funds held by a strata manager have limited protection by the Real Estate Special Compensation Fund. It is vital that strata council act quickly if documents are not provided as required or if discrepancies exist that cannot be justified.

How do you report investments?

Transparent disclosure of investments is essential. All decisions regarding the investment of funds are made by the strata council and reported in the strata council meeting minutes. It is suggested that the monthly financial reports produced by the treasurer or strata manager, include statements of all investment funds, copies of the investment certificates and yields. These reports are to be provided to strata council members for approval. In addition, the annual financial statement provides all details of financial

investments, rates of interests and accrued revenues to the respective accounts. Owners may, at any time, request to review the monthly financial reports or obtain a copy of the investment certificates as per sections 35 and 36 of SPA.

Example: Regulation 6.7 Financial Statement Requirements: The strata corporation must disclose the details of all income from all sources, and the details of any expenditures out of the operating fund.

Opening Balance	\$357,000.25
Income Contribution for 2013	55,000.00
Interest earned	5,728.13
Investment management expense	-2,500.00
Emergency expense elevator	- 12,000.00
¾ Resolution for Roofing (SGM Aug 12/13)	<u>- 77,425.00</u>
Closing Balance Dec 31/13	\$336,603.38

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