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## Finances

# Expanding Reserve Fund Investment Options

## An Investment Expert's Perspective



As the skylines of most major cities in Ontario will attest, this well-documented period of low-interest rates has contributed to the proliferation of new housing developments across Ontario. At last check, there were more than 9,000 condominium corporations in Ontario, representing some 600,000 units<sup>1</sup>. But it's these same low interest rates, coupled with very limited investment options, which make obtaining a good return on the investment of reserve funds for condominium corporations in Ontario very challenging.

### Eligible Securities

At the time of writing, Section 115(5) of the Condominium Act, 1998 defines eligible securities as bonds, debentures, GICs, deposit receipts or notes, or similar instruments that are: 1) issued or guaranteed by the Government of Canada or one of the Provinces; or 2) issued by an institution located in Ontario insured by the Canada Deposit Insurance Corporation (CDIC) or the Deposit Insurance Corporation of Ontario<sup>2</sup>.

CDIC eligible GICs, or guaranteed investment certificates, are sold at par (face

value) and promise the return of principal if held to maturity, along with an annual interest payment (commonly known as a coupon). Conventional GICs are available from a variety of providers, with varying terms to maturity that cannot exceed 5 years (a CDIC requirement). Longer terms pay the highest rates of interest (currently averaging 2.00%).

Several financial institutions have also created CDIC-eligible market-linked GICs, which can pay an annual payment (usually lower than prevailing rates) and a variable-return that is linked to a market index (basket of equities). However, there is typically no secondary market for these products and no guarantee that the variable-return will be greater than zero. The merits of these investments should be reviewed with the assistance of a licensed investment professional, in the overall context of the corporation's investment portfolio.

Government-backed bonds can be sold above or below par and with or without a coupon. While more liquid than GICs, these investments are not without risk

and condominium corporations can actually end up losing money if, in their quest for yield, they purchase long-term bonds above par<sup>3</sup>. An important measure for boards to take into account when purchasing bonds is the yield-to-maturity, which takes into account both the current price of the bond and the coupon payments.

The overarching challenge with these types of low-risk investments is that their average rate of return is currently at or below inflation<sup>4</sup>, essentially meaning that a condominium corporation can, at best, maintain its purchasing power by investing in longer-term securities (utilizing an investment ladder), or as is often the case lose the purchasing power of these funds while waiting for interest rates to rise.

### What could be done to offer condos the chance at better returns on investments?

Expanding the definition of "eligible securities" is a step that has been taken in other provinces. Looking to the West, the province of British Columbia (which currently boasts over 30,000 "stratas", representing more than 1,000,000 units) con-

*“The respondent argued that these matters need to come to court rather than mediation... This approach fanned the flames of conflict, and is a proper basis to reduce the respondent’s costs recovery.”*

*- D.L. Corbett J. | Diamantopoulos v. Metropolitan Toronto Condominium Corp. No. 594, 2013 ONSC 5988 (CanLII)*



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siders eligible securities to include some Canadian corporate bonds, and fixed income ETFs (that hold a minimum of 98% investment grade products) in addition to GICs and government-backed bonds that are permitted in Ontario<sup>5</sup>. And Alberta, which has approximately 8,000 condominium corporations and 440,000 units, allows investments in US, Canadian and UK government bonds; municipal bonds; some Canadian corporate bonds; preferred shares of Canadian corporations and even some dividend-paying common shares – limited to a maximum of 15% of the market value of the Corporation’s overall investment portfolio<sup>6</sup>.

While the risks of these types of securities should not be ignored, the underlying rationale is that the expansion of “eligible securities” should enable condominiums in these provinces to diversify risk while optimizing investment return, and ultimately enhancing the purchasing power of owners’ collective contingency/reserve fund contributions.

**The Bottom Line, Liquidity is KEY:**

As the former President of a condominium corporation, and an investment professional specializing in condominiums, I am hopeful that revisions to the *Ontario Condominium Act, 1998* will expand the types of eligible securities that corporations can consider for investment. That said,


any Board investment decisions should still be grounded in a formal investment plan, which ensures that the condominium corporation has sufficient liquidity to accommodate both planned and unplanned expenditures.

Section 115(8) of the Condominium Act, 1998 requires that: “Before investing any part of the money in the corporation’s reserve fund accounts, the board shall develop an investment plan based on the anticipated cash requirements of the reserve fund as set out in the most recent reserve fund study.”

The investment plan is separate and distinct from the reserve fund study or funding plan. And while the Act specifies that, “a reserve fund study shall be conducted by a reserve fund study provider”, the investment plan should be crafted with the help of a licensed investment professional. An investment plan outlines a strategy for the Board to consider, ensuring that funds are available when needed for major projects, while at the same time enhancing investment returns to the corporation. As a best practice, I encourage the review of investment plans annually, and a refresh, at minimum, every time a reserve fund study is updated.

As buildings age and their components begin to require replacement, the liquidity requirements of a corporation’s reserve

fund investment plans increase. Some fixed term investments, such as GICs, can be sold prior to maturity, but this is often at the discretion of the GIC provider and can involve the surrender of all interest earned to date, plus processing fees.

To avoid liquidity shortfalls, a reserve fund investment portfolio should consist of both fixed and non-fixed term securities, with fixed-term securities having ladder maturities and interest paid annually. A good rule of thumb to use, when determining the overall percentage of assets that should be held in non-fixed term securities, is to double the age of the condominium corporation. As an example, a 15 year old Corporation would ensure that 30% of its overall investment balance is available within a given fiscal year. 

- 1/ CCI Canadian Condominium Statistics, June 2016
- 2/ [www.ontario.ca/laws/statute/98c19](http://www.ontario.ca/laws/statute/98c19)
- 3/ Bond prices and interest rates are inversely related, meaning that as interest rates rise, the price of bonds falls. The magnitude of this relationship is termed duration. As an example: a 1% increase in interest rates will result in a 10% decline in the value of a bond with a ten-year average duration.
- 4/ At the time of writing, Total CPI inflation is 2.0%; [www.bankofcanada.ca/rates/indicators/key-variables/key-inflation-indicators-and-the-target-range/](http://www.bankofcanada.ca/rates/indicators/key-variables/key-inflation-indicators-and-the-target-range/)
- 5/ Permitted investments for money held in contingency reserve fund: [www.bclaws.ca/EPLibraries/bclaws\\_new/document/ID/freeside/12\\_43\\_2000#section6.11](http://www.bclaws.ca/EPLibraries/bclaws_new/document/ID/freeside/12_43_2000#section6.11)
- 6/ Authorized Corporation investments (P48): [www.qp.alberta.ca/documents/Regs/2000\\_168.pdf](http://www.qp.alberta.ca/documents/Regs/2000_168.pdf)



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