Keeping Condo Fees in Check

Reserve Fund Investing in a Low Rate Environment

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About our Firm

Raymond James is one of North America's leading independent full-service investment firms. As of September 1, 2018 Raymond James employs approximately 7,800 financial advisors who manage over $790 billion in client assets. A conservative firm based in St. Petersburgh, Florida, Raymond James remained profitable during the 2008 financial crisis and has completed 124 consecutive quarters of profitability. Raymond James Ltd. is a Fortune 500 company, the largest independent wealth management firm in Canada and the Canadian subsidiary of Raymond James Financial, Inc.

Fun Fact: The NFL's Tampa Bay Buccaneers play in "Raymond James Stadium"

About our Team- Contego Wealth Management

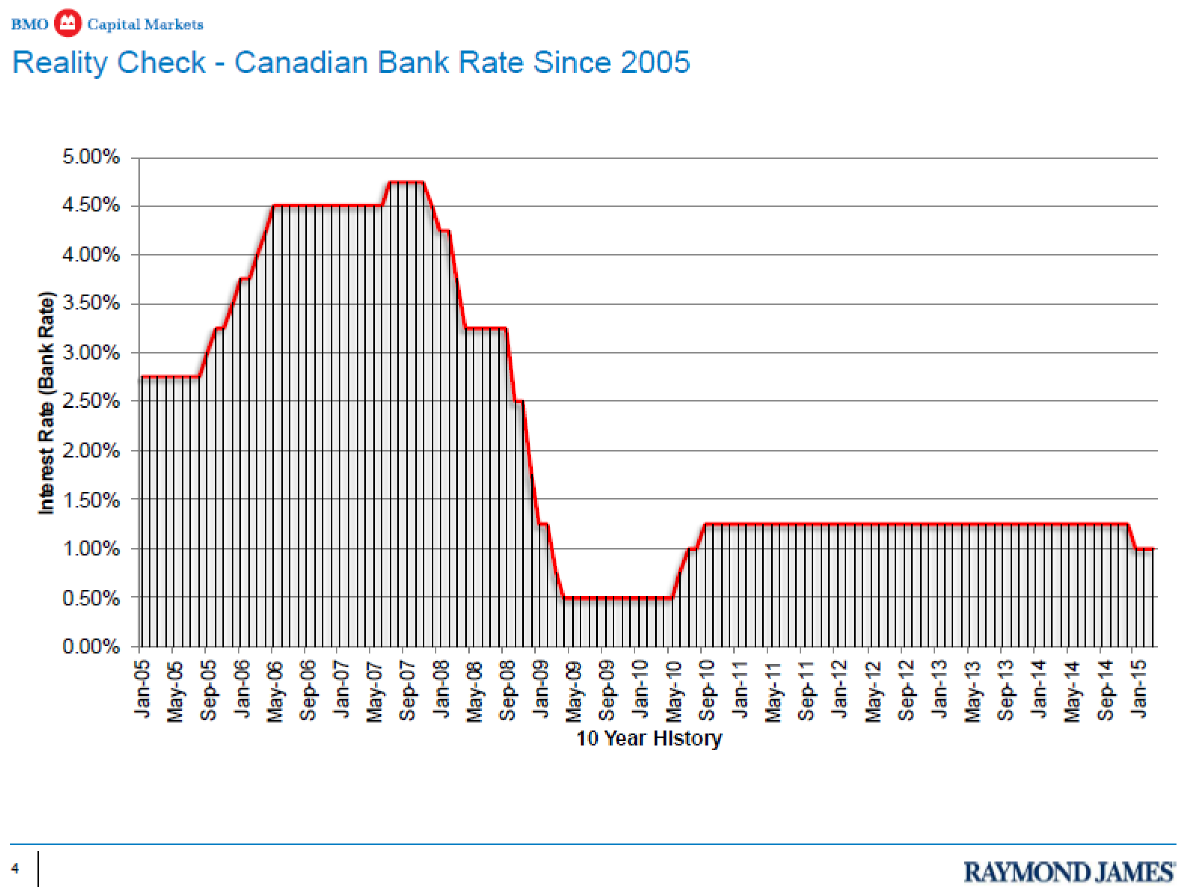
Contego: Latin word meaning "Protect" or "Safeguard"

Contego Wealth Management of Raymond James is a financial advisory team with over 75 years combined industry experience. As our name suggests, Contego Wealth Management focuses on pension-style portfolio management, encompassing risk control and tax efficiency (hence "protecting" the client's assets from market volatility and "safeguarding" them from undue taxation). We also focus on estate and retirement planning for:

- Incorporated professionals (doctors, dentists, lawyers)
- Successful business owners
- Professional athletes
- Condominium corporations
- Charities/ Not for profits

Contego Wealth Management's perpetual search for ways to generate optimal returns while mitigating risk, combined with Raymond James' institutional buying power to find the best GIC rates, gives Contego Wealth Management a very attractive offering to condominium corporations. **We can act as a "deposit broker" and are able to shop more than 30 of Canada's banks to find you the best interest rates.**

Reality Check for Condominium Corporations



Long gone are the days when a condominium reserve fund could invest in a simple GIC and earn 4% to 5%. With Canadian inflation currently around 1.90%, and the Canadian bank rate lower at 1.70%, many condo boards are having difficulty just keeping pace with inflation. This does not bode well in the battle against rising maintenance costs and, in turn, rising condo fees. Your reserve fund study assumes a fixed interest rate on your reserve fund. Virtually all condo corporations we have analyzed are not achieving this assumed interest rate. This means that at the next reserve fund study, the difference must be made up by the owners in the form of increased condo fees.

Many condo corporations are following the same investment strategies they applied during the high rate eras. Circumstances have changed, and in today's ultra-low rate environment, those managing reserve funds must dig a little deeper into the investment landscape in order to earn a positive real return (net of inflation) and allow the reserve fund to work for the condo corporation in keeping condo fees in check.

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The Condominium Act, 1998

Section 115: Key Points

Corporation's accounts

(2) A corporation shall maintain one or more accounts in its name designated as general accounts and one or more accounts in its name designated as reserve fund accounts. 1998, c. 19, s. 115 (2).

Definition

(5) In subsections (6) and (7),

"eligible security" means a bond, debenture, guaranteed investment certificate, deposit receipt, deposit note, certificate of deposit, term deposit or other instrument that is prescribed that,

(a) is issued or guaranteed by the Government of Canada or the government of any province or territory of Canada,

(b) is issued by an institution located in Ontario and is insured in accordance with the regulations by the Canada Deposit Insurance Corporation or the Deposit Insurance Corporation of Ontario, or

(c) is a security of a prescribed class.

Investment

(6) The board may invest all or any part of the money in the corporation's general accounts in eligible securities if,

(a) they are convertible to cash within 90 days following a request by the board; and

(b) they are,

(i) registered in the name of the corporation, or

(ii) held in a segregated account under the name of the corporation by a member of the Investment Dealers Association of Canada and insured by the Canadian Investor Protection Fund. 1998, c. 19, s. 115 (6).

Same, reserve fund accounts

(7) Subject to subsection (8), the board may invest all or any part of the money in the corporation's reserve fund accounts in eligible securities if they are,

(a) registered in the name of the corporation; or

(b) held in a segregated account under the name of the corporation by a member of the Canadian Investment Dealers Association and insured by the Canadian Investor Protection Fund. 1998, c. 19, s. 115 (7).

Investment plan

(8) 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. 1998, c. 19, s. 115 (8).

Reserve Fund Investment Planning

As you will see later in this document, we are generally able to find higher interest rates for condominium corporations than they will receive at a bank branch. However, our true value to condominium corporations is our cash flow planning. Through an in depth analysis of the corporation's reserve fund study, we match investment maturities with expected expenditures (while always leaving extra cash in case of emergencies). Generally, the longer you are able to put away money, the greater yield you are able to earn. Therefore, it does not make sense to have the entire corporation's money in a one year GIC, when there are no large expenditures planned for three years. In this case, a portion of the reserve fund could be put away for longer, and allow the fund to generate more interest. The *Condominium Act, 1998* requires the board to have a reserve fund investment plan. Contego Wealth Management provides an in depth plan for the board with the goal of maximizing yield, while meeting expected, and unexpected cash flow needs.

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Investment options for Condominium Corporations

There are alternatives to a 2% GIC…

As Canada's largest independent (non-bank owned) wealth management firm, we are able to "shop around" for the best rates. Due to our institutional buying power, and the fact that all the banks are competing against each other for our business, we are generally able to get much better rates than a condominium corporation would receive directly from their local bank branch.

High Interest Savings Account

You need cash available for your corporation's day to day expenses. However, this does not mean that you cannot earn a yield on this cash, while having it accessible. We have access to high interest savings accounts (HISA) from 30+ institutions, and even access to a chequing account which pays more interest than the big banks posted rates, and allows you to write cheques and transfer money from the account. Not only are these attractive options for your reserve fund, but for your operating fund as well. The below table compares posted rates from some of Canada's big banks, with the rates they will give us, as well as our best current rate. In the past we have taken on new condominium clients who worked with one of the big banks, and were able to put them in the same savings account, at the same bank, but earning 60% more interest.

As of April 18, 2019

Issuer	Posted Public Rate	Rate Through Raymond James
RBC	1.05%	1.60%
Manulife Bank	1.50%	1.70%
TD	0.50%	1.60%
Our Best		1.70%

GICs:

Same as with HISAs, we are able to shop around for the best rates, and the banks are willing to compete heavily for our business due to our institutional buying power. Although we are currently seeing historic low interest rates, GICs still play a major part in condominium reserve fund investments due to their guaranteed income, and the ability to match their maturities to expected expenditures. Unlike only a few years ago, a 1 year GIC typically has a greater interest rate than the assumed rate in the reserve fund study.

Bonds:

Bonds are permitted under the *Condominium Act, 1998* so long as they are issued by the government of Canada (or one of the provinces), or an institution located in Ontario which is insured by CDIC. At present, there are typically not any bonds which are more attractive than GICs.

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Market Linked GICs

Like a regular GIC, the initial investment (up to $100,000) is guaranteed by the Canadian Deposit Insurance Corporation (CDIC). However, as opposed to receiving a fixed interest payment, the interest payment is tied to the underlying equity/index. This generally allows for the possibility of greater returns than a GIC with a fixed interest payment. Your initial investment is fully guaranteed just like a regular GIC.

Examples:

Name	Underlying Asset	Term to Maturity	Maximum Return	Issue Date	Maturity Date
Canadian Financials Market Return GIC	S&P/TSX Capped Financials Index	5 years	25%	February 3, 2012	February 3, 2017

Actual Performance (Maturity February 3rd, 2017):

	Index Level		Return
Start	176.62	Actual Index % Gain	63.46%
Current	288.71	GIC % Gain	25.00%

Since the closing level of the index is greater than the maximum return on the asset, the maximum return (25%) would be returned if the GIC matured today. It is currently tough to find a regular 5 year GIC which returns greater than 3%. This 2% difference is substantial, especially for larger reserve funds. Unfortunately this example capped the performance.

Below is an example of a market linked GIC with no cap on performance:

Canadian Equity GIC (uncapped)

Investment Highlights:

- Term: 5 years
- 100% principal protected at maturity
- Participation factor: 100%
- Eligible for CDIC insurance
- No secondary market

The Canadian Equity GIC offers the growth potential of a Canadian diversified equity portfolio all while ensuring 100% principal protection. The variable interest is calculated at maturity based on the arithmetic average of the price return of 15 reference shares multiplied by the participation factor of 100%

See following page for details

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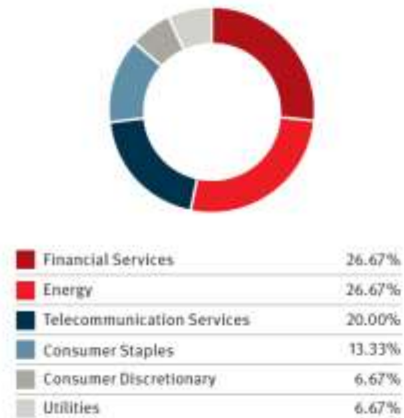
Reference Portfolio

Exposure to 15 Canadian companies

The Reference Portfolio Return calculation is based on the price return of the Reference Shares and will not take into account dividends paid on such shares (the dividends paid on account of all the Reference Shares represented an annual return of approximately 4.33% as of May 11, 2015).

- BCE Inc.
- The Bank of Nova Scotia
- Baytex Energy Corp.
- Canadian Imperial Bank of Commerce
- Crescent Point Energy Corp.
- Fortis Inc.
- Great-West Lifeco Inc.
- Inter Pipeline Ltd.
- Loblaw Companies Limited
- Rogers Communications Inc., Class B
- Shaw Communications Inc., Class B
- Sun Life Financial Inc.
- TELUS Corporation
- Thomson Reuters Corporation
- The Toronto-Dominion Bank

Sector diversification



An Improved Portfolio with a Focus on Capital Preservation

Most reserve funds we have reviewed are focused primarily on bank accounts, and one or two year GICs. Luckily engineering firms have lowered their assumed interest rate in reserve fund studies, but such allocations still make it difficult to meet the assumed rate.

Reserve Fund Sitting in Cash at a Bank

Rates as of April 18, 2019				
	Annual %	**% of portfolio**	**$ of portfolio**	**$ Return**
Cash	0.50%	100.00%	$500,000.00	$2,500
Total ($)			$500,000.00	$2,500
Total(%)		100.00%		0.50%
Portfolio Balance:		$500,000		

Reserve Fund with GIC Ladder

Rates as of April 18, 2019				
	Annual %	**% of portfolio**	**$ of portfolio**	**$ Return**
HISA	1.70%	10.00%	$50,000.00	$850
1 Year GIC	2.26%	20.00%	$100,000.00	$2,260
2 Year GIC	2.35%	20.00%	$100,000.00	$2,350
3 Year GIC	2.37%	20.00%	$100,000.00	$2,370
4 Year GIC	2.40%	20.00%	$100,000.00	$2,400
5 Year GIC	2.52%	10.00%	$50,000.00	$1,260
Total ($)			$500,000.00	$11,490
Total(%)		100.00%		2.30%
Portfolio Balance:		$500,000		

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Rates as of April 18, 2019				
	Annual %	% of portfolio	$ of portfolio	$ Return
HISA	1.70%	10.00%	$50,000.00	$850
1 Year GIC	2.26%	20.00%	$100,000.00	$2,260
2 Year GIC	2.35%	20.00%	$100,000.00	$2,350
3 Year GIC	2.37%	0.00%	$0.00	$0
4 Year GIC	2.40%	10.00%	$50,000.00	$1,200
5 Year ML GIC	4.00%	40.00%	$200,000.00	$8,000
Total ($)			$500,000.00	$14,660
Total(%)		100.00%		2.93%
Portfolio Balance:		$500,000		

Reserve Fund with a 20% allocation to a ML GIC which averages 4%/year

Mitigating the Risk of a 0% Return

Below are some examples of returns on portfolios comprised of High interest savings accounts (HISA), guaranteed investment certificates (GIC), and a market-linked GIC (ML GIC). These examples are based on $1,000,000 invested with various hypothetical returns on the ML GIC (0%, 4%, and 8%). They all assume 20% of the portfolio is invested in a ML GIC. This shows that in the worst case example where the ML GIC returns 0% a year, the portfolio still yields 1.82% overall. If the ML GIC averages 4% a year, the portfolio yields 2.63%, and if it averages 8% a year, the portfolio yields 3.42%

	Annual %	$ Invested	$ Return
HISA	1.70%	$100,000.00	$1,700.00
2 Year GIC	2.35%	$300,000.00	$7,050.00
3 Year GIC	2.37%	$400,000.00	$9,480.00
5 Year ML GIC	0%	$200,000.00	$0.00
Total	1.82%	$1,000,000.00	$18,230.00

	Annual %	$ Invested	$ Return
HISA	1.70%	$100,000.00	$1,700.00
2 Year GIC	2.35%	$300,000.00	$7,050.00
3 Year GIC	2.37%	$400,000.00	$9,480.00
5 Year ML GI	4%	$200,000.00	$8,000.00
Total	2.62%	$1,000,000.00	$26,230.00

	Annual %	$ Invested	$ Return
HISA	1.70%	$100,000.00	$1,700.00
2 Year GIC	2.35%	$300,000.00	$7,050.00
3 Year GIC	2.37%	$400,000.00	$9,480.00
5 Year ML GI	8%	$200,000.00	$16,000.00
Total	3.42%	$1,000,000.00	$34,230.00

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Using CDIC Coverage Illustration

The table below table compares two situations where a $400,000 reserve fund is invested entirely in a one year GIC with May 29th, 2017 rates. The first example shows the entire amount invested in one of Canada's big six banks. The second shows the fund being invested up to the CDIC coverage limit in a few of Canada's smaller banks.

Comparing 1 Year GIC Interest		
Using One of Big 6 Banks		
Amount	Yield	Interest
$400,000.00	1.05%	$4,200.00
Using CDIC Coverage		
Amount	Yield	Interest
$100,000.00	2.25%	$2,250.00
$100,000.00	1.75%	$1,750.00
$100,000.00	1.10%	$1,100.00
$100,000.00	1.05%	$1,050.00
Total	1.54%	$6,150.00
Difference	0.49%	$1,950.00

Notes :

- Canada's smaller institutions must offer better rates in order to win deposit business from the big six banks.
- CDIC coverage insures deposits up to $100,000 per institution.
- It can be worthwhile to split money among institutions to increase yield, without adding risk.
    - The second example would technically be safer as it is fully CDIC insured.

Rate Comparison

5/30/2017	Big 6	Best
HISA	0.9	1.5
1 Year	1.05	2.25
2 Year	1.25	2.45
3 Year	1.4	2.5
4 Year	1.6	2.55
5 Year	1.85	2.7

Final Thoughts

Rising maintenance costs, low interest rates and in turn, rising condo fees, are a frustrating reality for most condo owners and have resulted in decreased property values and lawsuits. Although rising costs of goods and services, unexpected maintenance, and other costs cannot be controlled by the condo board, they do have a **fiduciary duty** to ensure they take all appropriate measures to control the rise of condo fees. One way of doing so that is within their control is placing a greater emphasis on the return on investment in the reserve fund. Allowing hundreds of thousands, or millions of dollars to sit idly in a bank account or in GICs earning less than 1%, is a disservice to all unit owners. There are solutions which fit within the regulations on eligible securities for the reserve fund which offer the potential for a meaningful return while keeping the principal investment protected. A well-structured portfolio which corresponds with the anticipated cash flow needs set forth in the reserve fund study should provide the condo corporation with the additional money annually per resident which could be used to offset increases in condo fees.

Please contact Contego Wealth Management for a no obligation consultation of your condo corporation's investment portfolio and/or to subscribe to our monthly bulletin *Reserve Fund Monthly.*

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