



Depreciation Reports—Why the Interest and Inflation Rate Analysis Matters

“The greatest shortcoming of the human race is our inability to understand the exponential function” —Al Bartlett

When completing a depreciation report based upon the legislated requirements of the BC Strata Property Amendment Act, the strata property regulation 6.2 requires a financial forecasting section which includes:

6.2(3)(a) “the anticipated maintenance, repair and replacements for common expenses that usually occur less often than once a year or that do not usually occur, projected over 30 years, beginning with the current or previous fiscal year of the strata corporation, of the items listed in subsection (2) (b)”

6.2(3)(b) “a description of the factors and assumptions, including interest rates and rates of inflation, used to calculate the costs referred to in paragraph (a)”

The accurate and supportable selection of rates is critical in the preparation of a depreciation report’s financial analysis. As such, it is incumbent on the qualified professional to provide reasonable analysis and support of these rates within their report. The rates analyzed may include an interest rate, construction inflation rate, and CPI inflation rate; best practices would suggest all three.

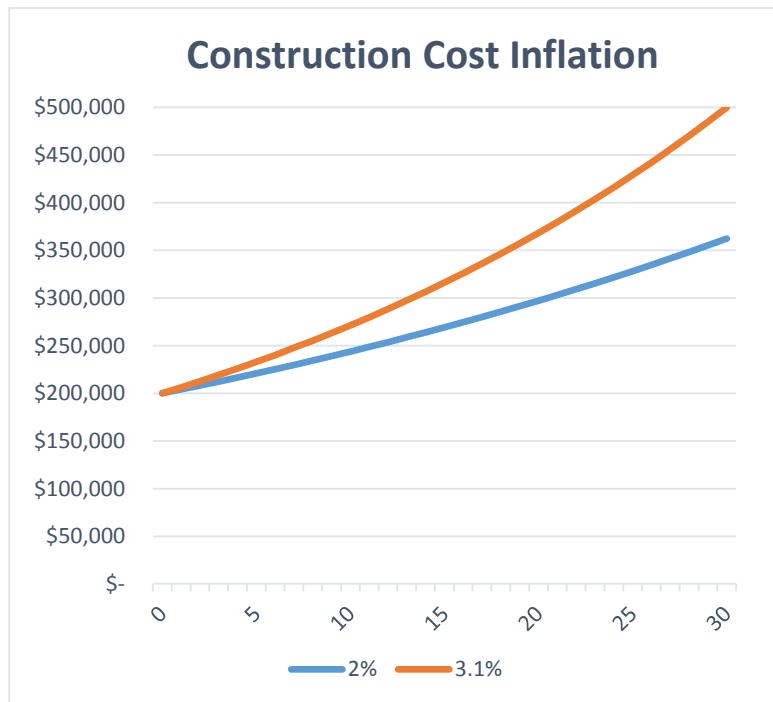
The importance of accurate analysis in support of the selected rates cannot be overstated. The difference, for example, in the selection of an unsupported and approximated rate of 2% versus a precise and supportable 30 year projected localized construction inflation rate for a particular class of construction of say, 3.1% compounded annually, is 64.5%. The long term effect of this difference (compounded annually) between a supported rate of 3.1% and a simple “guess” of 2% is significant. Consider the following example:

Component – current year cost \$200,000
 Component Age – new (2014)
 Component Life – 30 years
 Predicted Replacement Year – 2043

Replacement Cost at 2% compounded construction interest: \$362,272.32

Replacement Cost at 3.1% compounded construction interest: \$499,792.75

Difference in Dollars: \$137,520.44
 Difference in funding %: 38.0%



The exponential effect of an error which at first glance appears minor (2% assumption vs. 3.1% researched and supportable rate), has a dramatic effect on the estimated long term funding requirements. With a 2014 cost of \$200,000, the difference by year 30 is 38%—over \$137,000. This type of error would be repeated with each reserve component analyzed within the study.

It is important for the depreciation report consultant to take appropriate steps to carefully analyze and provide reasonable support for their selection of rates within the context of the regulation. What may appear on the surface to be a minor area of concern could result in a significant error over a 30 year projection period, when the long term effects of the exponential function are considered.

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