

ReserveFundBudget User Guide

The Sectional Title Schemes Management Regulations

Certain items on a Sectional Title scheme's budget are pretty predictable from year to year. For example, if you know how much was spent on gardening, electricity, managing agent's fees or insurance in one year, it is pretty easy make an educated guess as to the amount that will be spent on the same item in the following year. A first approximation would be to take the amount spent in the most recent financial year and assume that you will spend the same amount increased by the rate of inflation.

However, a Body Corporate's (BC's) expenses can vary wildly from year to year when certain expensive maintenance needs to be undertaken such as repainting, repaving a driveway or replacing a wall or fence. Unless a BC maintains a healthy reserve fund, these large capital items can result in levies changing dramatically from year to year. In particular, BC's may need to issue special levies which are frequently unpopular with owners.

The Sectional Title Schemes Management Regulations require that the trustees of a BC prepare:

- An administrative budget to cover day-to-day expenses (such as gardening, managing agent fees, electricity and regular repairs and maintenance like fixing minor plumbing problems or replacing light bulbs) for the following financial year
- A maintenance plan and budget that identifies large maintenance work that needs to be undertaken over the next ten years that shows how these large-scale works will be funded from a reserve fund.

The STSMR specifies that the reserve fund must be maintained separately from the administrative fund and stipulates amounts that must be contributed to the reserve fund each year. The minimum amounts that must be put into the reserve fund annually are significant. The following two slightly messy requirements apply (if, on a first reading, you don't understand them, don't worry):

1. If the amount in the reserve fund is insufficient to cover a full year's administrative costs but more than one quarter of the amount spent on administration, then the BC must ensure that an amount equal to the Repairs & Maintenance line item on the administrative budget must be contributed to the reserve fund.
2. If the amount in the reserve fund is less than one quarter of the amount spent on administration, a BC is required to put an amount of, at least, 15% of the total administrative budget into the reserve fund in the next financial year.

The reserve fund would be pointless if a BC was obliged to put money into the fund but could never take the money out again. Fortunately, money can be spent from the reserve fund but only on items in the ten year maintenance plan. For example, a BC may not pay its electricity bill out of the reserve

fund. If a BC finds that it cannot pay administrative costs (such as its electricity account or its auditing fees), it is obliged to raise a special levy.

There are a large number of items that can be included on a ten year plan and trying to make educated guesses as to whether the reserve fund will be sufficiently well funded at some distant time to meet is not realistic. Happily, spreadsheets are a great tool for budgeting and checking compliance with, e.g., points 1 and 2 from the STSMR above.

The *ReserveFundBudget* Spreadsheet

The Brittany, Tokai Villas trustees created a spreadsheet to help them:

- Identify items that need to be maintained over a ten year period (such as paint jobs, replacing electric fencing, resurfacing the pool, etc.)
- Determine what the impact of these big-ticket items is on the budget and how to prepare budgets that do not see significant fluctuations in levies from year to year.

This user guide describes how to use the spreadsheet.

Real world budgeting

It's important to be realistic; ten years is a long time period. A spreadsheet is not going to be precisely accurate over one year and the inaccuracies get worse over longer time periods. Some of the problems with long range budgeting are:

- Inflation can vary and the spread between the interest earned on the reserve fund can be significantly different from year to year over ten years
- Assumptions about when maintenance work is needed can be wrong; a paint job that was expected to last seven years may be looking shoddy after six
- Events that were assumed to have no realistic chance of happening may come to pass

The intellectually lazy might then assume that preparing a ten year plan is a waste of time. If that's your point of view, you should stop reading now. Budgeting can highlight potential problems without being 100% accurate.

The Structure of the Spreadsheet

The spreadsheet consists of six *worksheets*:

- An “About” worksheet that includes a copyright notice and a disclaimer
- A “Current Financials” worksheet that captures details from the previous year's (hopefully audited) financial statements and important details from the administrative budget
- A worksheet that captures items that need to be maintained over the next ten years (e.g. painting) or high capital purchases (e.g. a new irrigation system)
- A worksheet that gives an assessment of the current health of the reserves and a naive recommendation of the amount by which the levies should be increased (or decreased) over the previous year. This recommendation can serve as a starting point for your planning.
- A “Planning and Projections” worksheet to determine year on year changes over the ten year period to help ensure that the reserves of the BC are sufficient to cover the expenses for each year and to ensure that the amount in the reserve fund is always compliant with the STSMR.
- A “Summary” sheet that describes the impact of the ten year plan for the immediate financial year.

The next sections work through two example spreadsheets for planning. The examples make the same assumptions about the initial state of a BC but differ in the formality of the ten year plan. The first example uses somewhat informal planning while the second uses a checklist of items to budget for.

Disclaimers and Other Legal Stuff

The STSMR is a legal document and the creators of this spreadsheet are not lawyers. We have, however, tried to interpret the regulations correctly and reasonably.

It should be noted that Section 2 of the STSMR specifies minimum amounts that must be contributed annually to the reserve fund. However, Section 22(2) has a formula that stipulates how to calculate an annual amount that must be contributed to the reserve fund. Given a precise formula, it seems redundant to include a formula for the “minimum” amount to be contributed. We describe how we try to reconcile the formulas of Sections 2 and 22 in the worked examples in this guide. However it is your responsibility to ensure that the budgeted amount to be contributed to the reserve fund for your own scheme is reasonable.

A maintenance plan involves more than just calculations. You should prepare a text document that justifies the assumptions that you make in your budgeting and spreadsheet.

This spreadsheet is software and software inevitably has bugs. Note that the GNU Public License under which this software is made freely available includes this disclaimer:

This program is distributed in the hope that it will be useful,
but WITHOUT ANY WARRANTY; without even the implied warranty of
MERCHANTABILITY or FITNESS FOR A PARTICULAR PURPOSE. See the
GNU General Public License for more details.

This software is copyrighted. You may distribute budgets using this spreadsheet but do not remove the worksheet that contains the copyright notice.

Example Spreadsheets

This section considers two fictitious Sectional Title Schemes: The Acme Body Corporate (ABC) and the Zenith Body Corporate (ZBC).

The first example is some what simpler and the second takes a more formal approach. The spreadsheets are found in the examples folder.

Example 1: The Acme Body Corporate

The ABC have prepared their 2017/2018 administrative budget in which they've identified how much money they need to cover the day-to-day running costs of their scheme. The table below shows the results

| | <i>Amount</i> |
|---------------------------------|---------------|
| Repairs & Maintenance | R130 000 |
| Managing agent fees | R73 000 |
| Gardening contract | R170 000 |
| Utilities | R135 000 |
| Legal fees | R6 000 |
| Security | R170 000 |
| Auditors' fees | R16 000 |
| Insurance | R70 000 |
| Gardener and Caretaker salaries | R190 000 |
| Total | R960 000 |

The ABC have also sent off their financial statements for the previous financial year (2016/17) to their auditors. The previous year, ABC's total budget was R1,000,000 and their administration costs came to R900,000. So the difference between the R1,000,000 gathered on levies and the R900,000 paid for various services was put into their reserve/contingency/management fund. We'll assume that ABC's reserve fund R550,000 in it at the start of the year.

ABC's trustees now want to prepare a management budget. The data that they need are:

- The previous year's administrative costs (R900,000)
- The current year's total administrative budget (R960,000)
- The amount budgeted for Repairs & Maintenance (R130,000)
- The amount in the reserve fund at the start of the year (R550,000)
- An educated guess as to inflation (7%)
- The interest rate applicable to the account in which they keep their reserve funds (5%)

If you open the *example1.ods* spreadsheet and click on the “Current Financials” worksheet, you'll see

the above data captured.

| | | |
|----|--|-------------|
| 10 | | |
| 11 | Body Corporate Name | Acme |
| 12 | Current Financial Year | 2018 |
| 13 | Previous year administrative costs | R 900,000 |
| 14 | Previous year total budget | R 1,000,000 |
| 15 | Current year projected administrative costs | R 960,000 |
| 16 | Current year projected repairs and maintenance costs | R 130,000 |
| 17 | Current year initial reserve fund amount | R 550,000 |
| 18 | Assumed inflation rate | 7.00% |
| 19 | Bank deposit interest rate | 5.00% |
| 20 | | |
| 21 | | |

The actual planning now needs to start. The trustees have identified five expensive maintenance items that need to be repaired, maintained or replaced over the next ten years (2018-2027):

- The electric fence is beginning to look tatty and will need to be replaced. They've obtained a quote of R70,000 if it were done immediately. The trustees figure that the work can wait until 2019 (although, with inflation, it will cost more than R70,000 in *nominal* terms then)
- The walls of the complex are repainted every seven years and the next job will be in 2020 (and another in 2027). They estimate that currently (in 2018 Rand terms), it will cost R750,000.
- The irrigation system will be 20 years old in 2025 and they believe it should be replaced. An estimate of R80,000 in 2018 Rand term seems reasonable to them.
- ABC's caretaker tells them that the gutters and downpipes need replacing and should cost about R250,000. The trustees decide that maintenance work can be held over until 2021.
- Finally, woodwork and metalwork needs to be repainted every four years with the next round of repainting in the current financial year at a cost of R280,000. The exercise will be repeated in 2022 and 2026.

ABC's trustees capture their maintenance budget items in the "Ten Year Plan" worksheet.

| | | | | | |
|----|---------------------------------|------------|----------|--------------|----------------------|
| 15 | Item | Start Year | End Year | Step (years) | Annual amount (real) |
| 16 | Replacing the electric fence | 2019 | 2019 | 1 | R 70,000 |
| 17 | Repainting walls | 2020 | 2027 | 7 | R 750,000 |
| 18 | Replacing the irrigation system | 2025 | 2025 | 1 | R 80,000 |
| 19 | Replace gutters and downpipe | 2021 | 2021 | 1 | R 250,000 |
| 20 | Repaint woodwork | 2018 | 2026 | 4 | R 280,000 |
| 21 | | | | | |
| 22 | | | | | |

Note the step values of 7 and 4 for the repainting items above.

If you scroll over further right on the same spreadsheet, you'll see the same data captured on a year-by-year basis after applying the assumed rate of inflation.

From 2020 to 2027, ABC's reserve fund is “NOT OK” since the balance is negative and the scheme is bankrupt.

The spreadsheet is also complaining from 2018 to 2027 about the amount being contributed to the reserve fund. Initially, from 2018 to 2020, we see a “NOT OK1” warning. This warning means that the amount being contributed to the reserve fund is less than the amount being spent on Repairs & Maintenance. As the financial situation deteriorates the warning changes to “NOT OK2”. The STSMR requires that scheme's with inadequately funded reserves must put an amount greater than or equal to 15% of their overall administrative budget into the reserve fund. This budget would, from 2021, be failing to meet that legal requirement.

The spreadsheet recommended on the previous worksheet that the ABC increase their budget by 44.2% (in real terms). Let's see what happens if we do what the computer tells us to do.

| Year | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Proposed budget change real (%) | 44.20% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| Proposed budget change nominal (%) | 51.20% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% |
| Initial reserve (nominal) | R 550,000 | R 863,100 | R 1,447,782 | R 1,282,146 | R 1,734,715 | R 2,195,814 | R 3,118,524 | R 4,144,273 | R 5,147,312 | R 5,895,392 |
| Administrative budget (nominal) | R 960,000 | R 1,027,200 | R 1,099,104 | R 1,176,041 | R 1,258,364 | R 1,346,450 | R 1,440,701 | R 1,541,550 | R 1,649,459 | R 1,764,921 |
| Repairs & Maintenance (nominal) | R 130,000 | R 139,100 | R 148,837 | R 159,256 | R 170,403 | R 182,332 | R 195,095 | R 208,752 | R 223,364 | R 239,000 |
| Total budget (nominal) | R 1,512,000 | R 1,617,840 | R 1,731,089 | R 1,852,265 | R 1,981,924 | R 2,120,658 | R 2,269,104 | R 2,427,942 | R 2,597,898 | R 2,779,750 |
| Reserve fund budget (nominal) | R 552,000 | R 590,640 | R 631,985 | R 676,224 | R 723,559 | R 774,209 | R 828,403 | R 886,391 | R 948,439 | R 1,014,829 |
| Additional months of fund contributions needed for current year | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Reserve fund budget OK? | | | | | | | | | | |
| Reserve fund spending (nominal) | R 280,000 | R 74,900 | R 858,675 | R 306,261 | R 367,023 | R 0 | R 0 | R 128,463 | R 481,092 | R 1,378,844 |
| Final reserve (nominal) | R 863,100 | R 1,447,782 | R 1,282,146 | R 1,734,715 | R 2,195,814 | R 3,118,524 | R 4,144,273 | R 5,147,312 | R 5,895,392 | R 5,807,946 |
| Final reserve (months) | 10.8 | 16.9 | 14.0 | 17.7 | 20.9 | 27.8 | 34.5 | 40.1 | 42.9 | 39.5 |
| Final reserve OK? | | | | | | | | | | |

All the red disappears, so things are looking better in most respects. One problem, though, is going to be the angry hordes at the AGM. A second problem is that we have increased the budget (and levies) to solve an immediate problem. If we maintain the budget at this rate, we are going to be continuing to be throwing more and more money into the reserve fund. Looking at the column for 2027, we see that the spreadsheet (with excessive precision) predicts that by 2027 the amount in the reserve fund will be sufficient to cover 39.5 months (more than three years) of operating costs.

Since the interest earned is less than the rate of inflation, very large reserves will have their value eroded by inflation. It is possible to have too much money in a reserve fund. Let's try fixing that problem by reducing the budget in 2019. If we reduce the budget in 2019 by 25% in real terms (18% in nominal terms excluding inflation), we get a plan that looks pretty good.

| Year | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Proposed budget change real (%) | 44.20% | -25.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| Proposed budget change nominal (%) | 51.20% | -18.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% |
| Initial reserve (nominal) | R 550,000 | R 863,100 | R 1,050,882 | R 440,718 | R 396,805 | R 304,789 | R 612,692 | R 956,477 | R 1,204,487 | R 1,118,090 |
| Administrative budget (nominal) | R 960,000 | R 1,027,200 | R 1,099,104 | R 1,176,041 | R 1,258,364 | R 1,346,450 | R 1,440,701 | R 1,541,550 | R 1,649,459 | R 1,764,921 |
| Repairs & Maintenance (nominal) | R 130,000 | R 139,100 | R 148,837 | R 159,256 | R 170,403 | R 182,332 | R 195,095 | R 208,752 | R 223,364 | R 239,000 |
| Total budget (nominal) | R 1,512,000 | R 1,239,840 | R 1,326,629 | R 1,419,493 | R 1,518,857 | R 1,625,177 | R 1,738,940 | R 1,860,666 | R 1,990,912 | R 2,130,276 |
| Reserve fund budget (nominal) | R 552,000 | R 212,640 | R 227,525 | R 243,452 | R 260,493 | R 278,728 | R 298,239 | R 319,115 | R 341,453 | R 365,355 |
| Additional months of fund contributions needed for current year | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 8.6 |
| Reserve fund budget OK? | | | | | | | | | | |
| Reserve fund spending (nominal) | R 280,000 | R 74,900 | R 858,675 | R 306,261 | R 367,023 | R 0 | R 0 | R 128,463 | R 481,092 | R 1,378,844 |
| Final reserve (nominal) | R 863,100 | R 1,050,882 | R 440,718 | R 396,805 | R 304,789 | R 612,692 | R 956,477 | R 1,204,487 | R 1,118,090 | R 109,831 |
| Final reserve (months) | 10.8 | 12.3 | 4.8 | 4.0 | 2.9 | 5.5 | 8.0 | 9.4 | 8.1 | 0.7 |
| Final reserve OK? | | | | | Low | | | | | Low |

There are warnings that in 2022 and 2027, the amount in the reserve fund will be “low”. That warning means that the reserves are insufficient to cover three months' administrative costs but the projections don't look too bad on the whole. Unfortunately, the current trustees will probably be harangued for

hiking the levies dramatically while the next group of trustees will be praised for the financial acuity when they lower levies by 18% but still manage to present a balanced budget.

Rather than dramatically hiking levies and then slashing them, we should try to find a position with moderate increases over one or more years. If we increase the budget by 16% in real terms, the projection is that over the next ten years, things should be OK.

| Year | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Proposed budget change real (%) | 16.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| Proposed budget change nominal (%) | 23.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% |
| Initial reserve (nominal) | R 550,000 | R 567,000 | R 820,050 | R 284,023 | R 323,950 | R 326,384 | R 740,327 | R 1,202,800 | R 1,583,294 | R 1,644,417 |
| Administrative budget (nominal) | R 960,000 | R 1,027,200 | R 1,099,104 | R 1,176,041 | R 1,258,364 | R 1,346,450 | R 1,440,701 | R 1,541,550 | R 1,649,459 | R 1,764,921 |
| Repairs & Maintenance (nominal) | R 130,000 | R 139,100 | R 148,837 | R 159,256 | R 170,403 | R 182,332 | R 195,095 | R 208,752 | R 223,364 | R 239,000 |
| Total budget (nominal) | R 1,230,000 | R 1,316,100 | R 1,408,227 | R 1,506,803 | R 1,612,279 | R 1,725,139 | R 1,845,898 | R 1,975,111 | R 2,113,369 | R 2,261,305 |
| Reserve fund budget (nominal) | R 270,000 | R 288,900 | R 309,123 | R 330,762 | R 353,915 | R 378,689 | R 405,197 | R 433,561 | R 463,910 | R 496,384 |
| Additional months of fund contributions needed for current year | 0.0 | 0.0 | 1.5 | 0.8 | 1.5 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Reserve fund budget OK? | | | | | | | | | | |
| Reserve fund spending (nominal) | R 280,000 | R 74,900 | R 858,675 | R 306,261 | R 367,023 | R 0 | R 0 | R 128,463 | R 481,092 | R 1,378,844 |
| Final reserve (nominal) | R 567,000 | R 820,050 | R 284,023 | R 323,950 | R 326,384 | R 740,327 | R 1,202,800 | R 1,583,294 | R 1,644,417 | R 800,055 |
| Final reserve (months) | 7.1 | 9.6 | 3.1 | 3.3 | 3.1 | 6.6 | 10.0 | 12.3 | 12.0 | 5.4 |
| Final reserve OK? | | | | | | | | | | |

That 16% increase translates into a 23% levy increase in nominal terms. If the trustees aren't comfortable with such an increase in one go, they could investigate whether staggered increases over two or three years might work to get ABC into a sustainable position.

For example, a 10% (17% nominal) increase in 2018 followed by 6% (13% nominal) and 4% (11% nominal) increases in 2019 and 2020 would see the scheme able to meet the expense of the major repainting exercise in 2020.

| Year | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Proposed budget change real (%) | 10.00% | 6.00% | 4.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| Proposed budget change nominal (%) | 17.00% | 13.00% | 11.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% |
| Initial reserve (nominal) | R 550,000 | R 504,000 | R 760,200 | R 283,450 | R 389,976 | R 467,003 | R 964,260 | R 1,519,552 | R 2,003,219 | R 2,178,788 |
| Administrative budget (nominal) | R 960,000 | R 1,027,200 | R 1,099,104 | R 1,176,041 | R 1,258,364 | R 1,346,450 | R 1,440,701 | R 1,541,550 | R 1,649,459 | R 1,764,921 |
| Repairs & Maintenance (nominal) | R 130,000 | R 139,100 | R 148,837 | R 159,256 | R 170,403 | R 182,332 | R 195,095 | R 208,752 | R 223,364 | R 239,000 |
| Total budget (nominal) | R 1,170,000 | R 1,322,100 | R 1,467,531 | R 1,570,258 | R 1,680,176 | R 1,797,789 | R 1,923,634 | R 2,058,288 | R 2,202,368 | R 2,356,534 |
| Reserve fund budget (nominal) | R 210,000 | R 294,900 | R 368,427 | R 394,217 | R 421,812 | R 451,339 | R 482,933 | R 516,738 | R 552,910 | R 591,613 |
| Additional months of fund contributions needed for current year | 0.0 | 0.0 | 3.2 | 0.7 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Reserve fund budget OK? | | | | | | | | | | |
| Reserve fund spending (nominal) | R 280,000 | R 74,900 | R 858,675 | R 306,261 | R 367,023 | R 0 | R 0 | R 128,463 | R 481,092 | R 1,378,844 |
| Final reserve (nominal) | R 504,000 | R 760,200 | R 283,450 | R 389,976 | R 467,003 | R 964,260 | R 1,519,552 | R 2,003,219 | R 2,178,788 | R 1,461,134 |
| Final reserve (months) | 6.3 | 8.9 | 3.1 | 4.0 | 4.5 | 8.6 | 12.7 | 15.6 | 15.9 | 9.9 |
| Final reserve OK? | | | | | | | | | | |

That seems like a much more sensible bit of budgeting than the computer's suggestion that ABC hike levies by 51.2% in 2017/18. Why did the spreadsheet recommend that? The answer is in the final worksheet which summarizes the most important points of the 2017/18 budget.

| | | |
|----|--|-------------|
| 8 | Budget Summary | |
| 9 | Administrative budget | R 960,000 |
| 10 | Reserve fund budget | R 210,000 |
| 11 | Total budget | R 1,170,000 |
| 12 | Percentage change in budget | 17.0% |
| 13 | | |
| 14 | Reserve Fund Summary | |
| 15 | Initial reserves | R 550,000 |
| 16 | Recommended initial reserves | R 1,167,000 |
| 17 | Actual versus recommended difference | R-550,000 |
| 18 | Actual versus recommended difference (%) | -52.9% |
| 19 | | |
| 20 | Projected final reserves at year end | R 504,000 |
| 21 | Recommended final reserves | R 862,988 |
| 22 | Actual versus recommended difference | R-358,988 |
| 23 | Actual versus recommended difference (%) | -41.6% |
| 24 | | |
| 25 | Percentage change in reserves | -8.4% |
| 26 | Reserves in months | 6.3 |

Note that at the start of the financial year, ABC's reserve fund was 52.9% less than an ideal value. By increasing levies by only a nominal 17%, at the end of the financial year the amount in the reserve fund will still be less than an ideal value by 41.6%. If the trustees had hiked levies by 51.2% the BC would have had the recommended amount in the reserve fund at the end of the year.

Section 22(2) of the STSMR has a simple formula for calculating how much should be contributed to the reserve fund. Evaluating the formula as used in the spreadsheet would have got the reserves to the recommended value in a single year. However, it's not clear that it should be necessary for a BC to get to a fully funded reserve in one year since the STSMR also specifies the minimum amount to be contributed to the reserve fund. The ABC trustees can probably get their scheme healthy by staggered increases as long as:

- They contribute at least the minimum amounts to the reserve fund required by Section 2 of the STSMR and
- They inform the BC when presenting the budget that there will be future levy increases above the inflation rate and have a plausible plan to get into compliance in a reasonable number of years

Section 22(4) of the STSMR requires

“The trustees must report the extent to which the approved maintenance, repair and replacement plan has been implemented to each annual general meeting.”

It would seem that the trustees could legitimately explain that a BC will need to have levy (and budget)

increases above inflation to implement the “approved maintenance, repair and replacement plan”. In the example here, the difference between the actual and ideal amounts in the reserve fund was reduced significantly from a 52.9% shortfall at the start of the year to a 41.6% shortfall by the end of the year. In particular, the trustees could indicate that levy increases of 6% and 4% above inflation in the next two years might be sufficient to ensure the financial sustainability of the scheme.

That concludes Example 1 which had a somewhat simplistic maintenance plan with only five items. The second example is more detailed (it contains six items).

Example 2: The Zenith Body Corporate

The financial state of the Zenith Body Corporate is identical to that of the Acme Body Corporate and is captured in the *example2.ods* spreadsheet.

Drawing up a Ten Year Plan

The trustees of ZBC look at the STSMR and see that the STSMR breaks down “major capital items” into eleven categories:

- Wiring, lighting and electrical systems
- Plumbing, drainage and storm-water systems
- Interior and exterior painting and waterproofing
- Parking facilities, roadways and paved areas
- Security systems and facilities
- Community and recreational facilities
- Communication and service supply systems
- Lifts
- Carpeting and furnishings
- Roofing
- Heating and cooling facilities

Like the trustees of the Acme Body Corporate, ZBC's trustees identify that the complex needs to be repainted every few years, that the gutters, electric fence and irrigation system need to be replaced. As they go down the checklist, they get to the “Community and recreational facilities” heading and realize that they have a swimming pool that periodically needs to be resurfaced.

The ZBC trustees check their records and see that the swimming pool was last resurfaced in 2009 at a cost of R26,000. Pool resurfacing typically lasts about ten years and the trustees decide that they should assume that the pool may need to be resurfaced in 2019. Since nine years have elapsed since the last reurfacing, they calculate that the cost of resurfacing it now (in 2018) would come to $R26000 \times (1.07)^9 = R49,000$. The multiplying factor of 1.07 comes from their assumption that inflation has averaged 7% over the last nine years.

The resultant plan and estimated costs are shown.

| | | | | | |
|----|--|------|------|---|-----------|
| 21 | | | | | |
| 22 | Plumbing, drainage & storm-water system | | | | |
| 23 | Replace gutters and downpipes | 2021 | 2021 | 1 | R 250,000 |
| 24 | Replace irrigation system | 2025 | 2025 | 1 | R 80,000 |
| 25 | | | | | |
| 26 | | | | | |
| 27 | | | | | |
| 28 | Painting & waterproofing | | | | |
| 29 | Walls | 2020 | 2027 | 7 | R 750,000 |
| 30 | Woodwork & metalwork | 2018 | 2026 | 4 | R 280,000 |
| 31 | | | | | |
| 32 | | | | | |
| 33 | | | | | |
| 34 | Security | | | | |
| 35 | Replace the electric fence | 2019 | 2019 | 1 | R 70,000 |
| 36 | | | | | |
| 37 | | | | | |
| 38 | | | | | |
| 39 | | | | | |
| 40 | Recreational facilities | | | | |
| 41 | Resurface the pool | 2019 | 2019 | 1 | R 49,000 |
| 42 | | | | | |
| 43 | | | | | |
| 44 | | | | | |

Opening the “Current Year Planner” of the *example2.ods* spreadsheet shows that ZBC should have had R1,206,200 in its reserve fund and the actual reserves of R550,000 represent a shortfall of 54.6%. To get its reserves up to the recommended level in one year requires a real 46.6% (nominal 53.6%) increase in the budget over the previous year.

| | | |
|----|---|-------------|
| 12 | Actual initial reserve fund amount | R 550,000 |
| 13 | Recommended initial reserve fund amount | R 1,206,200 |
| 14 | Difference between actual and recommended | -54.4% |
| 15 | Recommended management fund contribution | R 575,507 |
| 16 | Recommended real budget change | 46.6% |
| 17 | Recommended nominal budget change | 53.6% |
| 88 | | |

If the ZBC were hoping to get away with budget increases that are limited to the rate of inflation, they're going to be disappointed as the next projection shows. Warnings about the contributions to the reserve fund are generated right from the start and by 2020 the scheme is bankrupt.

| | | | | | | | | | | | |
|----|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| 15 | Year | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 |
| 16 | Proposed budget change real (%) | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| 17 | Proposed budget change nominal (%) | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% |
| 18 | Initial reserve (nominal) | R 550,000 | R 399,000 | R 408,839 | R-340,092 | R-537,178 | R-798,014 | R-675,920 | R-536,382 | R-512,619 | R-844,946 |
| 19 | Administrative budget (nominal) | R 960,000 | R 1,027,200 | R 1,099,104 | R 1,176,041 | R 1,258,364 | R 1,346,450 | R 1,440,701 | R 1,541,550 | R 1,649,459 | R 1,764,921 |
| 20 | Repairs & Maintenance (nominal) | R 130,000 | R 139,100 | R 148,837 | R 159,256 | R 170,403 | R 182,332 | R 195,095 | R 208,752 | R 223,364 | R 239,000 |
| 21 | Total budget (nominal) | R 1,070,000 | R 1,144,900 | R 1,225,043 | R 1,310,796 | R 1,402,552 | R 1,500,730 | R 1,605,781 | R 1,718,186 | R 1,838,459 | R 1,967,151 |
| 22 | Reserve fund budget (nominal) | R 110,000 | R 117,700 | R 125,939 | R 134,755 | R 144,188 | R 154,281 | R 165,080 | R 176,636 | R 189,000 | R 202,231 |
| 23 | Additional months of fund contributions needed for current year | 0.0 | 0.0 | 42.9 | 57.6 | 75.3 | 62.1 | 49.1 | 45.2 | 63.1 | 132.0 |
| 24 | Reserve fund budget OK? | NOT OK1 | NOT OK1 | NOT OK1 | NOT OK2 | NOT OK2 | NOT OK2 | NOT OK2 | NOT OK2 | NOT OK2 | NOT OK2 |
| 25 | Reserve fund spending (nominal) | R 280,000 | R 127,330 | R 858,675 | R 306,261 | R 367,023 | R 0 | R 0 | R 128,463 | R 481,092 | R 1,378,844 |
| 26 | Final reserve (nominal) | R 399,000 | R 408,839 | R-340,092 | R-537,178 | R-798,014 | R-675,920 | R-536,382 | R-512,619 | R-844,946 | R-2,122,638 |
| 27 | Final reserve (months) | 5.0 | 4.8 | -3.7 | -5.5 | -7.6 | -6.0 | -4.5 | -4.0 | -6.1 | -14.4 |
| 28 | Final reserve OK? | | | NOT OK! | NOT OK! | NOT OK! | NOT OK! | NOT OK! | NOT OK! | NOT OK! | NOT OK! |
| 29 | | | | | | | | | | | |

The nominal 53.6% increase recommended on the “Current Year Planner” doesn't seem like something

that the trustees will be able to sell to the other members of the Body Corporate. The trustees note that the immediate problem is the paint job in the 2020 financial year and decide to try to stagger the increases evenly over the next three financial years. The projection is that real increases of 9%, 8% and 8% from 2018 to 2020 should be a financially acceptable solution/

| Year | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Proposed budget change real (%) | 9.00% | 8.00% | 8.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| Proposed budget change nominal (%) | 16.00% | 15.00% | 15.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% |
| Initial reserve (nominal) | R 550,000 | R 493,500 | R 706,619 | R 297,086 | R 479,085 | R 640,594 | R 1,232,156 | R 1,892,465 | R 2,492,812 | R 2,797,758 |
| Administrative budget (nominal) | R 960,000 | R 1,027,200 | R 1,099,104 | R 1,176,041 | R 1,258,364 | R 1,346,450 | R 1,440,701 | R 1,541,550 | R 1,649,459 | R 1,764,921 |
| Repairs & Maintenance (nominal) | R 130,000 | R 139,100 | R 148,837 | R 159,256 | R 170,403 | R 182,332 | R 195,095 | R 208,752 | R 223,364 | R 239,000 |
| Total budget (nominal) | R 1,160,000 | R 1,334,000 | R 1,534,100 | R 1,641,487 | R 1,756,391 | R 1,879,338 | R 2,010,892 | R 2,151,655 | R 2,302,270 | R 2,463,429 |
| Reserve fund budget (nominal) | R 200,000 | R 306,800 | R 434,996 | R 465,446 | R 498,027 | R 532,889 | R 570,191 | R 610,104 | R 652,812 | R 698,509 |
| Additional months of fund contributions needed for current year | 0.0 | 0.0 | 4.2 | 0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Reserve fund budget OK? | | | | | | | | | | |
| Reserve fund spending (nominal) | R 280,000 | R 127,330 | R 858,675 | R 306,261 | R 367,023 | R 0 | R 0 | R 128,463 | R 481,092 | R 1,378,844 |
| Final reserve (nominal) | R 493,500 | R 706,619 | R 297,086 | R 479,085 | R 640,594 | R 1,232,156 | R 1,892,465 | R 2,492,812 | R 2,797,758 | R 2,223,293 |
| Final reserve (months) | 6.2 | 8.3 | 3.2 | 4.9 | 6.1 | 11.0 | 15.8 | 19.4 | 20.4 | 15.1 |
| Final reserve OK? | | | | | | | | | | |

On closer examination, the trustees notice that, even though there are no warnings, the proposed budgeting won't work for them. They want to repaint in the first few months of the 2020 financial year. At the start of the financial year they will have reserves of only R706,619 (or thereabouts since projections are imperfect) while the paint job will cost a projected R858,675. Looking at the “Additional months of fund contributions needed for current year”, they see that it will take 4 months (or 4.2 according to the excessively precise predictions of the spreadsheet) before their reserves will be adequate to cover the full year's expenses. The trustees decide that they should aim for two equal levy increases in 2018 and 2019 so that the value of the “Additional months of fund contributions needed for current year” comes to zero. Two real increases of 13% (i.e. nominal increases of 20%) should satisfy their requirements.

| Year | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Proposed budget change real (%) | 13.00% | 13.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| Proposed budget change nominal (%) | 20.00% | 20.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% |
| Initial reserve (nominal) | R 550,000 | R 535,500 | R 862,019 | R 467,291 | R 665,328 | R 844,203 | R 1,454,564 | R 2,135,215 | R 2,757,566 | R 3,086,308 |
| Administrative budget (nominal) | R 960,000 | R 1,027,200 | R 1,099,104 | R 1,176,041 | R 1,258,364 | R 1,346,450 | R 1,440,701 | R 1,541,550 | R 1,649,459 | R 1,764,921 |
| Repairs & Maintenance (nominal) | R 130,000 | R 139,100 | R 148,837 | R 159,256 | R 170,403 | R 182,332 | R 195,095 | R 208,752 | R 223,364 | R 239,000 |
| Total budget (nominal) | R 1,200,000 | R 1,440,000 | R 1,540,800 | R 1,648,656 | R 1,764,062 | R 1,887,546 | R 2,019,674 | R 2,161,052 | R 2,312,325 | R 2,474,188 |
| Reserve fund budget (nominal) | R 240,000 | R 412,800 | R 441,696 | R 472,615 | R 505,698 | R 541,097 | R 578,973 | R 619,501 | R 662,867 | R 709,267 |
| Additional months of fund contributions needed for current year | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Reserve fund budget OK? | | | | | | | | | | |
| Reserve fund spending (nominal) | R 280,000 | R 127,330 | R 858,675 | R 306,261 | R 367,023 | R 0 | R 0 | R 128,463 | R 481,092 | R 1,378,844 |
| Final reserve (nominal) | R 535,500 | R 862,019 | R 467,291 | R 665,328 | R 844,203 | R 1,454,564 | R 2,135,215 | R 2,757,566 | R 3,086,308 | R 2,537,567 |
| Final reserve (months) | 6.7 | 10.1 | 5.1 | 6.8 | 8.1 | 13.0 | 17.8 | 21.5 | 22.5 | 17.3 |
| Final reserve OK? | | | | | | | | | | |

That's probably the least unpalatable solution that the trustees can impose on the owners.

Finally, the important points of the budget for the immediate year are summarized with levies going by 20% and the shortfall in the reserves dropping from R656,200 at the start of the year to R352,282 by the end of the year. Despite undertaking some expensive maintenance work during the year, the reserves should only drop by about 2.6% by the end of the year.

| | | |
|----|--|-------------|
| 8 | Budget Summary | |
| 9 | Administrative budget | R 960,000 |
| 10 | Reserve fund budget | R 240,000 |
| 11 | Total budget | R 1,200,000 |
| 12 | Percentage change in budget | 20.0% |
| 13 | | |
| 14 | Reserve Fund Summary | |
| 15 | Initial reserves | R 550,000 |
| 16 | Recommended initial reserves | R 1,206,200 |
| 17 | Actual versus recommended difference | R-656,200 |
| 18 | Actual versus recommended difference (%) | -54.4% |
| 19 | | |
| 20 | Projected final reserves at year end | R 535,500 |
| 21 | Recommended final reserves | R 887,782 |
| 22 | Actual versus recommended difference | R-352,282 |
| 23 | Actual versus recommended difference (%) | -39.7% |
| 24 | | |
| 25 | Percentage change in reserves | -2.6% |
| 26 | Reserves in months | 6.7 |

There are other experiments that the trustees could play around with:

- What happens if the pool resurfacing needs to take place in 2018 instead of 2019?
- How much can they reduce the levies by if the pool resurfacing is never needed?
- What happens if the paint job in 2020 costs R1 million instead of R860,000?
- What happens if the paint job carried out in 2020 lasts only for six years instead of seven and the next wall repainting needs to move forward from 2027 to 2026?

The spreadsheet can give answers to all those questions and others. Obviously the answers are absurdly precise but they hopefully resemble reality and can give the trustees some confidence that the BC is budgeting prudently.

Preparing your own Reserve Fund Spreadsheet

The STSMR is a recent piece of legislation and it's not clear what its effect is going to be on bodies corporate in practice. Some complexes have probably always had conservative planning with large reserves while others have probably had trustees who tried to placate owners by preparing budgets that were naively optimistic. The requirements of the STSMR are fairly onerous and trustees may largely ignore it believing that, in practice, there won't be any penalties for ignoring it. That would be a pity because the good parts of the legislation would seem to outweigh the bad.

Hopefully this spreadsheet will take some of the pain out of complying with the STSMR. The *ReserveFundBudget.ods* spreadsheet is blank but with the eleven categories of major repair items that a BC may need to spend money on. All it needs is for you to start filling it with items, amount and percentage changes.

If you find the spreadsheet useful, please let us know by emailing trustees@brittanytokaivillas.com

Appendix: Assumptions of the Spreadsheet Modelling

This appendix is for informational purposes; read it only if you're interested.

The STSMR requires that trustees of a BC prepare a ten year plan. Trying to predict financial health over a ten year period with precision is challenging if not impossible. This appendix details how the spreadsheet calculates the expected reserves and the amounts needed for maintenance work in each of the ten years. There are several factors that affect the accuracy of these projections:

- High interest rates and inflation rates adversely affect the accuracy of projections
- Legislative or societal changes may make projections difficult. For example, if some maintenance work is labour-intensive and wages in the sector are increased significantly, the initial projections will be inaccurate
- Commodity price variations can make prediction difficult. E.g. If demand for aluminium goes up, then maintenance work that requires aluminium is going to cost more than initially assumed.

This appendix details how the spreadsheet determines the projected administrative costs, the projected cost of maintenance work, the final reserves at the end of a financial year and how much should be in the reserve fund at the start of a year.

Projecting Administrative Costs

The simplest calculation is the projection of administration costs over a ten year period. Looking at the costs from 2018 to 2027 below, we see that the administrative budget goes up from R960,000 in 2018 to R1,027,200 in 2027. The value of R1,027,200 = R960,000 x 1.07 or the value from 2018 plus a simple increase based on the assumed rate of inflation. Similarly the value for 2020, again assumes a 7% increase over the 2019 amount (R1,099,104 = 1.07 x R1,027,200).

| 15 | Year | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 |
|----|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| 16 | Proposed budget change real (%) | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| 17 | Proposed budget change nominal (%) | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% | 7.00% |
| 18 | Initial reserve (nominal) | R 550,000 | R 399,000 | R 408,839 | R-340,092 | R-537,178 | R-798,014 | R-675,920 | R-536,382 | R-512,619 | R-844,946 |
| 19 | Administrative budget (nominal) | R 960,000 | R 1,027,200 | R 1,099,104 | R 1,176,041 | R 1,258,364 | R 1,346,450 | R 1,440,701 | R 1,541,550 | R 1,649,459 | R 1,764,921 |
| 20 | Repairs & Maintenance (nominal) | R 130,000 | R 139,100 | R 148,837 | R 159,256 | R 170,403 | R 182,332 | R 195,095 | R 208,752 | R 223,364 | R 239,000 |
| 21 | Total budget (nominal) | R 1,070,000 | R 1,144,900 | R 1,225,043 | R 1,310,796 | R 1,402,552 | R 1,500,730 | R 1,605,781 | R 1,718,186 | R 1,838,459 | R 1,967,151 |
| 22 | Reserve fund budget (nominal) | R 110,000 | R 117,700 | R 125,939 | R 134,755 | R 144,188 | R 154,281 | R 165,080 | R 176,636 | R 189,000 | R 202,231 |
| 23 | Additional months of fund contributions needed for current year | 0.0 | 0.0 | 42.9 | 57.6 | 75.3 | 62.1 | 49.1 | 45.2 | 63.1 | 132.0 |
| 24 | Reserve fund budget OK? | NOT OK1 | NOT OK1 | NOT OK1 | NOT OK2 | NOT OK2 | NOT OK2 | NOT OK2 | NOT OK2 | NOT OK2 | NOT OK2 |
| 25 | Reserve fund spending (nominal) | R 280,000 | R 127,330 | R 858,675 | R 306,261 | R 367,023 | R 0 | R 0 | R 128,463 | R 481,092 | R 1,378,844 |
| 26 | Final reserve (nominal) | R 399,000 | R 408,839 | R-340,092 | R-537,178 | R-798,014 | R-675,920 | R-536,382 | R-512,619 | R-844,946 | R-2,122,638 |
| 27 | Final reserve (months) | 5.0 | 4.8 | -3.7 | -5.5 | -7.6 | -6.0 | -4.5 | -4.0 | -6.1 | -14.4 |
| 28 | Final reserve OK? | | | NOT OK! | NOT OK! | NOT OK! | NOT OK! | NOT OK! | NOT OK! | NOT OK! | NOT OK! |
| 29 | | | | | | | | | | | |

The accuracy of this prediction is dependent on a number of factors:

- How applicable is the assumed rate of inflation to *all* the items in the administrative budget. For example, if the price of water goes up by 20% and the cost of water makes up only 5% of the

administrative budget, the calculation may be reasonably accurate. If the water budget makes up 30% of the overall administrative budget, the calculation may be off by a significant amount.

- The size of the scheme for which the budget is being prepared. Schemes with more units (and bigger budgets) are likely to find this calculation relatively more accurate than smaller complexes. Suppose that 15% of units typically experience plumbing-related problems in a year. Now in a complex with 60 units we would expect 9 units to need repairs in a year. If it happens that one more unit than expected needs repairs, a reasonable estimate is that the plumbing line item will be out by about $(10 / 9)$ or about 11%. For a complex with 20 units, we would expect repairs to be needed at 3 units. If 4 units experience problems in one year at the complex, the plumbing budget could be assumed to be out by 33%.

The calculation of the Repairs & Maintenance projections is done in the same way as for the total administrative budget.

Projecting Maintenance Costs

When preparing the ten year plan, the costs should be expressed in current Rand terms and the spreadsheet will then apply the assumed inflation rate to estimate the nominal cost in the year of interest. For example, if repainting a complex at the start of the 2018 financial year would cost R750,000 but the work is only scheduled to happen in 2020 (2 years later) and, again, in 2027 (9 years later) and inflation is running at 7%, then the projected (nominal) costs are

$$R750,000 \times (1.07)^2 = R858,675$$

$$R750,000 \times (1.07)^9 = R1,378,844$$

If you look at the *example1* and *example2* spreadsheets, you'll see that those are the estimates in the spreadsheet. There are a couple of minor problems with this:

- The estimate of inflation is imprecise and the general rate of inflation might not be applicable to the activity
- The assumption is that the activity will happen at the same time of year as the estimate is based. For example, if an estimate is calculated at the start of a financial year but the activity takes place at the end of the corresponding financial year, the estimate will be off by about the rate of inflation (i.e. about 7% in the above example). You can compensate for this by modifying the original estimate. For example, if you anticipate that the activity will take place 6 months (0.5 years) into the financial year, multiply the estimate by $(1.07)^{0.5}$ and replace the R750,000 with an estimate of R776,000.

The (nominal) estimate of reserve fund expenses for a year is, unsurprisingly, simply the sum of the individual maintenance costs for the year. For example, if we estimate that in 2019 we will spend R74,900 on replacing the electric fence and R52,430 on resurfacing the pool (as captured in the “Ten Year Plan” worksheet) then the “Reserve Fund Spending” value for 2018 on the “Planning and Projections” worksheet is $R74,900 + R52,430 = R127,330$.

Projecting Final Reserves

The spreadsheet estimates the amount in the reserve fund at the end of each financial year (which is the same as the estimate for the initial reserves at the start of the current financial year). The calculation is quite naive, it is evaluated as

$$(\text{initial reserves} - \text{reserve fund spending} + \text{reserve fund budget}) \times (1 + \text{interest rate})$$

For example, if in 2018, we have initial reserves of R550,000, we spend R280,000 from the reserves, have a reserve fund budget for the year of R240,000 and our interest rate is 5% then the final reserve fund amount is estimated to be

$$(R550,000 - R280,000 + R240,000) \times 1.05 = R535,500$$

| 15 | Year | 2018 |
|----|---|-------------|
| 16 | Proposed budget change real (%) | 13.00% |
| 17 | Proposed budget change nominal (%) | 20.00% |
| 18 | Initial reserve (nominal) | R 550,000 |
| 19 | Administrative budget (nominal) | R 960,000 |
| 20 | Repairs & Maintenance (nominal) | R 130,000 |
| 21 | Total budget (nominal) | R 1,200,000 |
| 22 | Reserve fund budget (nominal) | R 240,000 |
| 23 | Additional months of fund contributions needed for current year | 0.0 |
| 24 | Reserve fund budget OK? | |
| 25 | Reserve fund spending (nominal) | R 280,000 |
| 26 | Final reserve (nominal) | R 535,500 |
| 27 | Final reserve (months) | 6.7 |
| 28 | Final reserve OK? | |

The calculation is naive because:

- The calculation is valid only if interest is calculated and compounded annually. If interest is calculated monthly, the actual interest earned on a positive balance would be greater
- Interest rates may vary depending on the amount in the reserve fund.
- The interest earned is a function of when in the year spending happens.

None of the above limitations is necessarily serious if interest rates are low. For example, a nominal interest rate of 5% if compounded monthly is equivalent to an effective interest rate of 5.1% compounded annually. Not a big difference.

Calculating Ideal Reserve Fund

Section 22 has this formula for calculating how much must be paid into the Reserve Fund for each item on the ten year maintenance planning

The annual contribution to the reserve fund for the maintenance, repair or replacement of each of the major capital items must be determined according to the following formula: [(estimated

cost minus past contribution) divided by expected life]

There are three issues with this:

- “Expected life” has the unusual definition of “the estimated number of years before it is expected that the cost of maintenance, repair or replacement of a major capital item will be incurred” So, if it is expected that in nine years time a paint job will be required. “expected life” means 9 years even if the paint job is expected to only be good for 4 years.
- It is not explained whether “estimated cost” is in “real” or “nominal” terms. The spreadsheet uses the real (i.e. current cost) of the work and neglects inflation. Since the reserve fund should be in an interest-bearing account, this seems to be a more sensible interpretation than assuming that the cost should use the nominal value of the work using an estimate of inflation.
- “Past contribution” is a particularly difficult term to understand unless a BC has kept a meticulous record of the amount contributed in each preceding year towards a particular capital item. We assume that a BC knows only the **total** amount in the reserve fund without knowing the constituent contributions that made up the reserve fund. We explain next how we calculate an estimate of the “past contribution” to determine what this year's contribution should be.