Does HST Affect Your Reserve Plan?

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Of course it does, but not very much, and certainly not enough to spend even more money on early reserve fund study updates – with only a few exceptions.

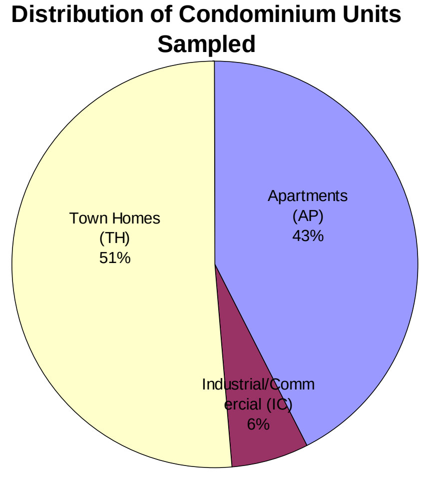
On July 1, 2010, Ontario will change the way it collects taxes. Ontario's current sales tax system, the Retail Sales Tax (RST), results in homeowners paying tax-on-top-of-tax. Until Canada Day next year it remains embedded in the cost of doing work. Generally speaking it applies mostly to material goods. However, when it gets combined with the federal GST (Goods and Services Tax), and becomes the Harmonized Sales Tax (HST) it will be applied to more items. The most notable of those being things that are primarily labour or service based. So, common expense budgets will include as much as 8% more for management fees, professional services, and utilities.

Three prominent research papers have been published that discuss the overall impact of changing the tax collection method:

- Smart, Michael. 2007. "Lessons in Harmony: What Experience in the Atlantic Provinces Shows About the Benefits of a Harmonized Sales Tax". C.D. Howe Institute Commentary No. 253.
- Drummond, Don and Diana Petramala. September 18, 2009. "The Impact of Sales Tax Harmonization in Ontario and B.C. on Canadian Inflation". TD Economics Special Report.
- Stokes, Ernie and Robin Somerville. 2009. "Made in Ontario: The Case for Sales Tax Harmonization". The Centre for Spatial Economics (C_4SE) for The Ontario Chamber of Commerce.

Their conclusions: very little net impact. Next to nothing. Some things go up, some things go down, and there will be initial turbulence as it all shakes out and politics plays its course. From a condominium standpoint, there will be increased new home purchase costs, decreased construction costs, and no effective change in repair construction.

Okay, sounds good so far. But what do economics researchers really know about reserve fund planning? Reserve fund studies, legally mandatory in Ontario, help condominium Boards of Directors develop a plan for future funding. That plan is based on the recurring costs of major repair and replacement of all the common elements. Currently, those recurring costs, or line items, each have a different embedded RST component in them. In many of them it is a compounded tax-on-tax. The change in those numbers will depend mostly on how much labour, or material, is in the work proposed. Calculating the exact effect would be a nightmare of convoluted assumptions, and we all know what happens when we assume!



Still, considering the prominence of reserve fund contributions in condominium budgets, we felt something meaningful needed to be done to at least get a feel for the possible impact. So, being planners and all, we took a look at the worst case scenario, as follows:

- Identified 30 recent reserve fund studies representing a cross-section of Ontario condominiums.
- Increased all current cost estimates by 8%, the very worst possible and most highly unlikely scenario.
- Recalculated the annual contributions required to satisfy all eight of our adequacy requirements.

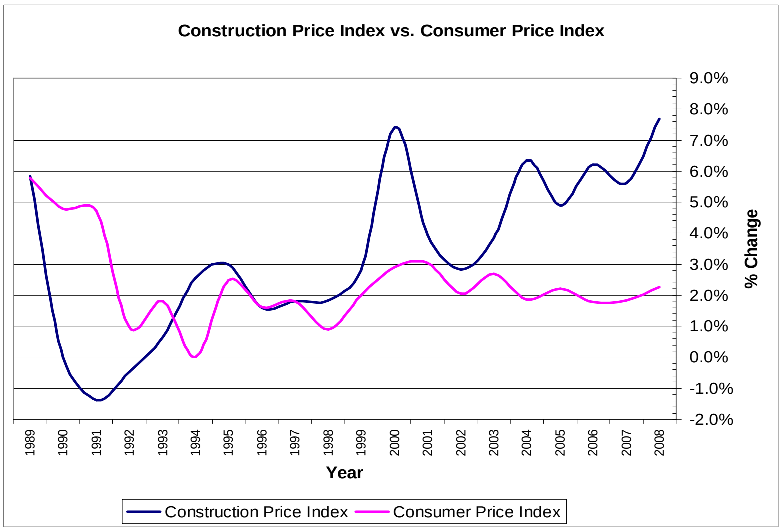
Three simple steps, but a surprisingly time-consuming task. Here's what we found:

Monthly Reserve Contributions per Unit			
Condo	**Planned Year 2**	**After Max. Possible HST Impact**	**Percent Change**
AP	128	129	0.8%
IC	113	114	1.5%
TH	85	86	1.2%
Overall	100	101	1.1%
	Planned Years 2, 3, & 4	**After Max. Possible HST Impact**	**Percent Change**
AP	135	139	2.7%
IC	124	127	3.1%
TH	99	102	3.4%
Overall	111	115	3.1%
	Planned Years 1 to 10	**After Max. Possible HST Impact**	**Percent Change**
AP	167	179	7.2%
IC	150	159	6.3%
TH	141	152	7.3%
Overall	150	160	7.2%

- In the second year of these plans, very small (1.5% and less) increases to contributions are required.
- For the second, third, and fourth years combined, under 3.5% total, or under 1.2% annually.
- For the first decade, less than 7.5% or under 1% annually.
- Roughly, a dollar per unit per month overall.
- Even based on an extremely unlikely cost increase – a full 8% - there is little real adverse affect on the plans for future funding.

Why? Well, here are some reasons:

- Good plans have already accounted for repair and replacement cost increases in the short-term that are in the order of 6.5% anyway, because that's what the rate of change has been lately, much higher than the consumer price index.
- Closing balances exist, because contributions are usually more than expenditures (except when the occasional really expensive project happens), and even if there is some real HST impact the balance will just be a bit lower. If a plan is so precarious that the balance plus contributions cannot absorb a small change in expenditures, then it was a bad plan anyway.
- Large reserve fund expenditures are – or should be – subject to a well-managed competitive tendering process based on professionally prepared specifications that solicit quotations from several suitably qualified restoration contractors.



In conclusion, there is no merit in conducting an earlier than expected reserve fund study update just because of the HST. Typically, reserve fund studies and their consequent plans for future funding only need to be updated for these reasons:

- The statutory three-year time is upon you.
- Your common elements have changed dramatically from the conditions or quantities upon which the plan is based.
- Actual fund balances are drastically different from those predicted.
- Expenditures are grossly higher than planned – not just by the HST.

Unfortunately, the same will not hold true for the other 60% to 80% of things that make up a condominium budget. For labour, services, and utilities those taxes are going to be paid by the consumer. The notion is that other tax relief, available to individuals, will help offset those changes. Or so they say.

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