

Reserve Fund Investments: Are they Eligible?

The investment of the monies held by a condominium corporation on account of its reserve fund is an important and critical function that has to be examined very carefully by each condominium corporation. It is imperative that corporations retain qualified investment advisors who have experience in dealing with condominium corporations and are familiar with the investment provisions of the *Condominium Act, 1998*.

Large condominium corporations will have a substantial reserve fund and as a result, the interest earned on those monies can be a significant amount.

The old *Condominium Act* did not address the issue of investment by the corporation of the funds maintained in the reserve account. Section 40(4) of the old Act simply stated that the monies had to be held in a “separate account” at a chartered bank, loan or trust company and as such, the interest earned was minimal. The focus was to insure that the capital portion of the reserve fund was never at risk.

The purpose and intention of section 115 of the new Act is to allow a condominium corporation the flexibility to invest in other vehicles thereby increasing the reserve fund capital’s rate of return. However, although there is flexibility, there are still strict guidelines as to how the money can be invested. This is where the concept of “eligible security” comes in.

Under Section 115, the condominium corporation can only invest the reserve fund monies in investments that are defined as “eligible securities”, which are bonds, debentures, guaranteed investment certificates, deposit receipts, deposit notes, certificates of deposit, term deposits or other similar instruments provided that these instruments are:

- a) issued or guaranteed by the Government of Canada or the Government of any province of Canada,
- b) issued by an institution located in Ontario and insured by the Canada Deposit Insurance Corporation (**CDIC**) or
- c) a security of a prescribed class.

Section 1(1) of the Act states that the word “prescribed” means prescribed by the regulations made under this Act. In other words, a certain investment can be an “eligible security” if it is listed in the regulations to the Act. Currently, no forms of securities are listed in the regulations. As such, subsection 115(5) (c) is currently inapplicable.

Once it is determined what the eligible securities are, then pursuant to section 115(7) those eligible securities can be placed with a brokerage firm to hold these investments provided the brokerage firm is a member of the Canadian Investment Dealers Association (CIDA) and insured by the Canadian Investor Protection Fund (CIPF).

In other words, the Act requires there to be two levels of protection for these investments.

The first level is that a condominium corporation is permitted to use an investment company to make investments provided the investment company is a member of the CIDA and insured by the CIPF. Then, the second level is that the investments that the brokerage firm makes must be “eligible securities”. It is not enough that the securities are invested by a brokerage house covered by the CIDA and insured by the CIPF. That alone does not make them “eligible securities” and as such the investment would be contrary to section 115. For example, investment dealers may suggest mutual funds, corporate paper or bond funds as investment vehicles. Although the brokerage firm is a member of the CIDA and insured by the CIPF, the investment vehicles are not “eligible securities” under section 115 and thus are ineligible. An interesting conundrum that many corporations are faced with, are bond funds. These vehicles are similar to mutual funds except the monies are invested in a variety of bonds. Certain bond funds only invest in bonds that are issued by the Government of Canada or the provinces. While the bonds itself would qualify as an “eligible security”, the bond fund which holds the bonds is not and therefore any investment in such would be ineligible.

It is important to keep in mind that although an investment dealer is a member of the CIDA and insured by the CIPF, this only protects the condominium corporation in the event the investment dealer is negligent or there is a problem with the dealer’s firm. It does not protect the

condominium corporation against the fluctuation in the value of the security. This is why it must be an eligible security. The capital portion of the investment in “eligible securities” are guaranteed and/or insured. If the corporation suffers a loss to the capital portion of their investment as a result of market fluctuation, the CIDA and the CIPF cannot help them.

If the corporation’s monies are presently invested in “ineligible securities”, the corporation must take the necessary steps to transfer those to eligible securities. However, they should keep in mind though that depending on the type of investment, transferring or cashing in prior to maturity may trigger penalties or loss of interest. This can amount to significant costs to the corporation. The board of directors should review this issue with their corporation’s solicitor to determine what their best course of action is. The solicitor may suggest that to limit the amount of cost, the transfer of the securities should be done as and when the specific investment matures thus reducing any loss of interest or penalty. The downside to this strategy is that it could take several years if there are long term investments, a court may not look favourably on a condominium corporation holding ineligible securities and thus demand that they be exchanged immediately. As of yet, the Courts have not looked at what the penalty is for non-compliance, nor have they adjudicated on whether a corporation would be justified in allowing these ineligible securities to mature before they transfer to an eligible security in order to ensure the least amount of damages. It would seem reasonable that a court would find that a condominium corporation would be acting prudently if they recognized the need to transfer their ineligible securities to eligible securities but did so with the least amount of monetary loss.

If a corporation has ineligible securities, the board should be reviewing this issue with their financial advisor and questioning them as to why they were invested in those securities in the first place. Financial advisors with condominium experience should be aware of what constitutes an eligible security.

The ramifications of investing in “ineligible securities” can be severe not only because of costs associated with transferring same but more importantly, ineligible securities inherently carry a risk to the capital portion of the investment which can cause serious and long term damage to the financial strength of the reserve fund and therefore the condominium corporation itself.